No. 78-411

In the Supreme Court of the United States

OCTOBER TERM, 1978

INTERSTATE COMMERCE COMMISSION, PETITIONER

v

CHICAGO AND NORTH WESTERN TRANSPORTATION COMPANY, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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CITATIONS

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The Interstate Commerce Commission petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. A, pp. la-43a),[1] as modified by its order on rehearing (App. C, pp. 45a-47a), is not yet reported.

The initial report of the Interstate Commerce Commission (App. E, pp. 50a-97a) is reported at 354 I.C.C. 129. The Commission's report on reconsideration (App. F, pp. 98a-116a) is reported at 354 I.C.C. 214.

JURISDICTION

The judgment of the court of appeals (App. B, p. 44a) was entered on May 30, 1978. A timely petition for

[1] "App." refers to the Appendix to this petition.

rehearing was granted in part and denied in part on July 31, 1978 (App. C, pp. 45a-47a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and 2350(a).[*]

QUESTION PRESENTED

Under Section 1a of the Interstate Commerce Act, whenever the Interstate Commerce Commission finds upon application that the public convenience and necessity permit abandonment of a line of railroad, it must publish its finding in the Federal Register. If, within 30 days of publication, it further finds that a financially responsible person has offered financial assistance that is likely to cover the difference between the revenues attributable to the line and the "avoidable cost" of providing rail freight service on the line, together with a reasonable return, the Commission must postpone issuance of a certificate of abandonment for a reasonable period "not to exceed 6 months" to enable the offeror to enter into an agreement with the railroad to provide such financial assistance. Section 17(9)(g) of the Act authorizes the Commission to reopen and reconsider decisions on the basis of "material error, new evidence, or substantially changed circumstances."

The question presented is whether, under Section 17(9)(g), the Commission has authority to reopen an underlying abandonment proceeding on the basis of substantially changed circumstances and to reconsider its order authorizing abandonment, if it finds at the conclusion of the six-month negotiating period provided by Section 1a that the railroad has refused to accept an offer of financial assistance that comports with the statutory standards.

[*]The Interstate Commerce Commission is authorized by statute to file this petition for a writ of certiorari. 28 U.S.C. 2350(a).

STATUTES AND REGULATIONS INVOLVED

1. Section 1a of the Interstate Commerce Act, 49 U.S.C. 1a, as added by Section 802 of the Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act), Pub. L. 94-210, 90 Stat. 127, is reproduced as an appendix to the opinion of the court of appeals (App. 37a-43a).

2. Section 17(9)(g) of the Interstate Commerce Act, 49 U.S.C. 17(9)(g), as added by Section 303(a) of the 4R Act, 90 Stat. 48, provides:

> The Commission may, at any time upon its own initiative, on grounds of material error, new evidence, or substantially changed circumstances—
> (i) reopen any proceeding;
> (ii) grant rehearing, reargument, or reconsideration with respect to any decision, order, or requirement; and
> (iii) reverse, modify, or change any decision, order, or requirement.
> The Commission may establish rules allowing interested parties to petition for leave to request reopening and reconsideration based upon material error, new evidence, or substantially changed circumstances.

3. 49 C.F.R. 1121.38(i)(2) provides:

> (2) If during the 6-month negotiation period the parties are unable to execute a financial assistance agreement, the Commission may—
> (i) Issue a final certificate at the end of the 6-month period which shall become effective and may be conditioned in accordance with the provisions of section 1a of the act and these regulations;

(ii) Reopen the underlying abandonment or discontinuance proceeding to reevaluate the application on its merits in light of the financial assistance offer;

(iii) Direct the carrier to continue to provide rail freight service for an additional year in return for compensation to be computed by the Commission from its earlier determination under section 1a(7) of the act, as modified to reflect current circumstances, and in accordance with the standards established in subpart D of these regulations; or

(iv) Take whatever action is appropriate in the particular situation and in conformity with section 1a of the act. Such action may include but not be limited to setting the matter for arbitration subject to the final review of the Commission.

STATEMENT

1. In the Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act), Congress prescribed a new procedure for the abandonment of lines of railroad. The procedure was designed to allow railroads expeditiously to reduce financial losses from uneconomical branch line operations, while making it possible for local communities "to keep their rail service" by agreeing either to purchase the line or to subsidize the operation to the extent necessary to assure the railroad a reasonable return on the value of the line. S. Rep. No. 94-499, 94th Cong., 1st Sess., p. 44 (1975). The Congressional objective was to preserve "essential trackage" but to do so "in a fashion that does not endanger the economic condition of the railroad industry." *Ibid.*

The new abandonment procedure, codified as Section 1a of the Interstate Commerce Act, 49 U.S.C. 1a, provides that a railroad may not abandon a line or discontinue operation of service on a line unless the Interstate Commerce Commission issues a certificate declaring that the public convenience and necessity permit the abandonment or discontinuance. §1a(1). Whenever the Commission finds, upon application by a railroad, that the public convenience and necessity permit the abandonment or discontinuance of a line of railroad, it must publish the finding in the Federal Register as notice to potential purchasers or subsidizers. §1a(6)(a).[3]

Thirty days after the date of publication, the Commission must issue a certificate authorizing the abandonment or discontinuance, unless it finds that (§1a(6)(a)):

(i) a financially responsible person (including a government entity) has offered financial assistance (in the form of a rail service continuation payment) to enable the rail service involved to be continued; and

(ii) it is likely that such proffered assistance would—

(A) cover the difference between the revenues which are attributable to such line of railroad and the avoidable cost of providing rail freight service on such line, together with a reasonable return on the value of such line; or

[3]Section 1a(6)(b) provides that railroads shall promptly make available to persons considering offering financial assistance information concerning the physical condition of the line, "together with such traffic, revenue, and other data as is necessary to determine the amount of assistance that would be required to continue rail service."

(B) cover the acquisition cost of all or any portion of such line of railroad; * * *

If the Commission makes these findings, it must postpone the issuance of a certificate "for such reasonable time, not to exceed 6 months, as is necessary to enable such person or entity to enter into a binding agreement [with the railroad] * * *." *Ibid.* When such an agreement is executed, the Commission must further postpone issuance of a certificate for as long as the agreement is in effect. *Ibid.*

2. After the 4R Act was enacted, the Commission published a notice of proposed rulemaking to implement the Act's new abandonment procedures. 41 Fed. Reg. 31878 (1976). In November 1976, after considering the written comments submitted by interested persons, the Commission adopted the regulations at issue in this case (codified as 49 C.F.R. Part 1121) and released a report fully addressing the issues raised by the public comments (App. 50a-97a).[4]

Section 1121.38 of the Commission's regulations implements the Act's financial assistance procedures. It provides that if, during the six-month period when issuance of a certificate is postponed to permit execution of a financial assistance agreement, the parties are unable to execute such an agreement, the Commission may follow one of four courses of action: (1) it may issue the certificate at the end of the six-month period; (2) it may "[r]eopen the underlying abandonment or discontinuance proceeding to reevaluate the application on its merits in light of the financial assistance offer"; (3) it may direct the railroad to continue providing service

[4]In response to petitions for reconsideration, the Commission subsequently modified the regulations in minor respects and issued a further report (App. 98a-116a).

for one year in return for financial assistance computed by the Commission; or (4) it may take any other appropriate action consistent with Section 1a of the Act, including directing arbitration. 49 C.F.R. 1121.38(i)(2). Only the second of these four courses of action—reopening the underlying abandonment proceeding—is at issue here.

The Commission stated that, while it would exercise its power to reopen the underlying abandonment proceeding "sparingly, and only upon evidence of clear recalcitrance on the part of the applicant carrier," it considers the provision "necessary to effectuate the intent of Congress that every opportunity be afforded to preserve rail service, especially if a potential subsidizer has made a reasonable offer of financial assistance" (App. 75a). Although the statute "anticipates that an agreement will be reached within the 6-month period" and "does not specifically provide for the situation" in which no agreement is reached (App. 112a), the Commission did "not believe the intent was to provide a means whereby a recalcitrant carrier [by simply refusing to negotiate or rejecting reasonable offers] could unfairly preclude the reaching of a reasonable agreement" (App. 111a-112a).

The Commission sought, by providing for reopening and other possible action, to "preclude both the potential subsidizer and the railroad from using the language of the act as a club at the negotiation table" (App. 112a).

The Commission bottomed its authority to reopen the underlying abandonment proceeding on Section 17(9)(g) of the Act, 49 U.S.C. 17(9)(g), which authorizes the Commission "at any time" to reopen a proceeding and reconsider a decision "on grounds of material error, new evidence, or substantially changed circumstances." The Commission stated: "It seems clear that if a bona fide

offer of subsidy could result in a change in the substantive factors that were determinative of the initial [public convenience and necessity] findings (*e.g.*, removal of the financial burden from the applicant carrier), then the subsidy offer produces a substantially changed condition central to the underlying abandonment proceeding" (App. 111a).

3. The court of appeals set aside this provision of the regulations (App. 1a-43a).[5] It held that the Commission has no alternative but to issue the certificate at the end of the six-month period, regardless of the circumstances. "What is a reasonable time * * * was for Congress to decide in light of its apparent determination to grant relief from the prolonged administrative proceedings that had attended abandonment and discontinuance" (App. 11a).

The court held that the Commission could not properly invoke Section 17(9)(g) to reopen the underlying abandonment proceeding, because "the existence of an impasse in subsidy negotiations [cannot] constitute 'substantially changed circumstances' " within the meaning of that section (App. 11a). Since the Commission does not consider the availability of subsidy in making its initial abandonment decision, the court reasoned, neither a subsequent offer of financial assistance by a subsidizer nor a refusal by the railroad to accept the offer "can * * * be a 'changed circumstance' justifying reopening of that decision" (App. 11a).[6]

[5]The court of appeals also reviewed other challenged provisions of the Commission's regulations, upholding some and invalidating some. The Commission here seeks review only of that portion of the court of appeals' judgment that set aside the reopening provision. Section 1121.38(i)(2)(ii).

[6]The court of appeals denied the Commission's petition for rehearing and suggestion for rehearing *en banc* as to this issue (App. 45a-47a).

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REASONS FOR GRANTING THE WRIT

1. The decision of the court of appeals eviscerates the local rail service assistance program established by Congress in the 4R Act. Congress sought to improve the economic health of the railroads by mitigating their financial losses from branch line service. But the heart of its plan was to give States and local communities the ability to preserve services they consider essential if they are prepared to pay a subsidy sufficient to assure the railroads a reasonable return on the value of the line. S. Rep. No. 94-499, 94th Cong., 1st Sess., pp. 43-44 (1975).[7]

By depriving the Commission of the power to reopen an underlying abandonment proceeding, and by holding that the Commission must in all cases issue a certificate of abandonment at the conclusion of the six-month negotiation period, the court of appeals has made it impossible for the Commission to ensure that a railroad will negotiate in good faith with a local community seeking to preserve its rail service. Under the court's

(footnote 6 continued)

Upon the Commission's motion, the court of appeals, on August 11, 1978, stayed the issuance of its mandate for 30 days to permit the filing of a petition for a writ of certiorari (App. 48a - 49a). The stay was conditioned, however, on the Commission's "proceed[ing] with the reconsideration of regulations required by our decisions with a view to the ultimate issuance of new regulations in conformity with that decision" (App. 49a). The Commission has satisfied that condition. On September 8, 1978, it issued a notice inviting public comment on how it should amend its regulations to comport with the holdings of the court of appeals.

[7]In Section 803 of the 4R Act, codified as 49 U.S.C. 1654, Congress directed the Secretary of Transportation to provide financial assistance to States for programs that cover rail subsidy or acquisition costs. Section 803 also authorized the appropriation of $360 million for these and related purposes.

decision, a recalcitrant railroad will be free to use the threat of abandonment to insist upon unreasonable subsidy amounts or conditions; it will also be free to refuse to discuss subsidy at all and simply wait six months for its certificate of abandonment.

This result undercuts the Congressional purpose. Congress did not intend to put local communities at the mercy of the railroads. Its carefully balanced plan was designed to ensure only a reasonable return to the railroads, not windfall profits,[8] and it was intended to protect local communities from the loss of essential rail services if they could offer the necessary financial assistance. The Senate Committee on Commerce stated that its "paramount concern * * * is the impact of rail abandonments on local communities, mostly rural in character. The Local Rail Service Assistance Program offers these communities an opportunity to keep their rail service." S. Rep. No. 94-499, *supra*, p. 44.[9] The decision of the court of appeals substantially endangers that opportunity.

[8]Section 1a(6)(a) provides that the Commission must postpone issuance of a certificate of abandonment for up to six months if it finds that a financially responsible person has offered financial assistance likely to "cover the difference between the revenues which are attributable to such line of railroad and the avoidable cost of providing rail freight service on such line, together with a *reasonable return* on the value of the line" (emphasis added). The purpose of the postponement is "to enable such person * * * to enter into a binding agreement * * * to provide *such assistance*" (emphasis added). Congress intended to ensure a reasonable return to the railroads. It did not intend to subject local communities to financial demands beyond that level.

[9]One important element of the Local Rail Service Assistance Program is the funding mechanism established by Congress to help States provide the financial assistance necessary to maintain rail service. See note 7, *supra*.

2. Contrary to the court of appeals' decision, Section 17(9)(g) of the Act, 49 U.S.C. 17(9)(g), provides ample authority for the Commission to reopen an underlying abandonment proceeding if it finds that a railroad has refused to accept a financial assistance offer that would provide the railroad a reasonable return consistent with the statutory standards. That section authorizes the Commission to reopen a proceeding and reconsider a decision on the basis of "substantially changed circumstances." The court of appeals held that Section 17(9)(g) is unavailable because a railroad's recalcitrance at the subsidy negotiation stage "can hardly be a 'changed circumstance' justifying reopening of [the abandonment] decision" (App. 11a). But the court misconceived the nature of the underlying abandonment determination.

In determining whether the public convenience and necessity permit the abandonment of a line of railroad, the Commission must balance the need for the service against the financial burden it imposes on the railroad. The issue is whether the "degree of dependence of the communities directly affected upon the particular means of transportation" justifies requiring the railroad "to continue to bear the financial loss necessarily entailed by operation." *Colorado* v. *United States*, 271 U.S. 153, 168. See also S. Rep. No. 94-499, *supra*, p. 40. When an abandonment is authorized, therefore, the decision rests on a finding that the financial burden outweighs the public need.

If the subsidy negotiation process subsequently produces a responsible offer of financial assistance that would eliminate the financial burden and give the railroad a reasonable return, and if the railroad refuses to accept the offer, that presents substantially changed circumstances that materially affect both sides of the balance. Not only does such an offer hold out assurances that the railroad's financial loss from the line will be

eliminated, but also it constitutes a significant tangible demonstration of the extent to which the local communities consider themselves dependent upon the rail line. See S. Rep. No. 94-499, *supra*, p. 44 (the Act "rightfully places the responsibility for making the decisions on the essentiality of local rail service with State and local officials"). For that reason, reopening on the basis of "substantially changed circumstances" would plainly be warranted under Section 17(9)(g).

The court of appeals relied erroneously on the language of Section 1a(6) that limits to six months the period during which the Commission may postpone issuance of a certificate. A reopening under Section 17(9)(g) is not, we submit, a "postponement" of the issuance of a certificate within the meaning of Section 1a(6). Its purpose is to reconsider the initial abandonment decision itself. Although reopening may have the *effect* of postponing the issuance of a certificate, nothing in the Act, and certainly nothing in the legislative history, suggests that the Commission's authority to reopen under Section 17(9)(g), also added by the 4R Act, was to be suspended in the case of abandonment decisions.[10]

[10]Likewise, although a provision of the Regional Rail Reorganization Act of 1973 (3R Act), 45 U.S.C. 744(c)—which applies only to northeast railroads in reorganization—prohibits certain abandonments if a reasonable subsidy offer is made, the absence of a similar provision in Section 1a of the Interstate Commerce Act does not support the court's conclusion that the Commission may not exercise its power to reopen and reconsider an abandonment decision (see App. 11a). Indeed, under the 3R Act, railroads are entitled to abandon their lines as a matter of law, and there is no underlying Commission abandonment decision that could be reopened. That may explain why Congress included in the 3R Act a prohibition against abandonment if a reasonable subsidy offer is made. Congress may have concluded that a similar prohibition was not needed in Section 1a because the Commission's

(footnote continued on next page)

Finally, the court of appeals considered its holding fortified by the fact that the Commission, five months before it issued its regulations, asked Congress to remove from Section 1a(6)(a) the words "not to exceed 6 months." See App. 10a, n. 9. The Commission at that time feared that the six-month limitation on its postponement authority could make it possible for a railroad to avoid negotiating in good faith and frustrate the efforts of a local community to preserve its rail service.

But that expression by the Commission does not support the court of appeals' conclusion that Congress was unsympathetic to the Commission's concerns. As this Court stated in *American Trucking Associations, Inc.* v. *Atchison, T. & S.F. Railway*, 387 U.S. 397, 418: "The advocacy of legislation by an administrative agency—and even the assertion of the need for it to accomplish a desired result—is an unsure and unreliable, and not a highly desirable, guide to statutory construction." Indeed, in the present case, a reasonable reading of Congress's silence in the face of the Commission's request is that Congress saw no need to

(footnote 10 continued)

supervision of the entire abandonment process under that section, including the power to reopen the underlying abandonment decision, gives it ample authority to ensure that local communities have a reasonable opportunity to preserve essential rail services.

The Commission is not asserting that Section 1a imposes a prohibition against abandonment whenever a reasonable subsidy offer is made. It asserts only the traditional authority of an administrative agency, as codified by Section 17(9)(g), to reopen and reconsider a decision in light of substantially changed circumstances material to the original decision. Cf. *American Farm Lines* v. *Black Ball Freight Service*, 397 U.S. 532, 540-542; *Baldwin* v. *Scott County Milling Co.*, 307 U.S. 478, 483-484.

amend the statute because the Commission already had ample authority to protect local communities. That is the view that the Commission itself came to after considering the public comments in its rulemaking proceeding. As in the *American Trucking Associations* case, the Commission's earlier testimony before Congress contains no "evidence of an administrative interpretation of the Act which should tilt the scales against the correctness of the Commission's conclusions as to its authority" (387 U.S. at 417-418).

CONCLUSION

The petition for a writ of certiorari should be granted. Respectfully submitted.

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SEPTEMBER 1978.

APPENDIX A

In the
United States Court of Appeals
For the Seventh Circuit

Nos. 76-2283, 77-1008 and 77-1487

CHICAGO AND NORTH WESTERN TRANSPORTATION COMPANY, et al.,

Petitioners,

v.

UNITED STATES OF AMERICA, and INTERSTATE COMMERCE COMMISSION,

Respondents.

COMMONWEALTH OF PENNSYLVANIA,

Intervenor.

On Petition for Review of Orders and Regulations of the Interstate Commerce Commission.

ARGUED SEPTEMBER 12, 1977—DECIDED MAY 30, 1978

Before FAIRCHILD, *Chief Judge,* SPRECHER and TONE, *Circuit Judges.*

TONE, *Circuit Judge.* New provisions governing the abandonment of railroad lines and the discontinuance of rail service were adopted by Congress as part of the Railroad Revitalization and Regulatory Reform Act of 1976 (the 4-R Act), 90 Stat. 127, 146, §§ 802, 809(c), and codified as § 1a of the Interstate Commerce Act, 49

U.S.C. § 1a.[1] Pursuant to these provisions, the Interstate Commerce Commission adopted implementing regulations. 41 Fed. Reg. 48520 as amended 42 Fed. Reg. 25327 (to be codified in 49 C.F.R. §§ 1121.10, et seq.). The several petitions for review before us challenge these regulations as inconsistent with the statute insofar as they (a) permit indefinite postponement of the issuance of a certificate of abandonment when a subsidization offer has been made but an agreement is not reached between the railroad and the potential subsidizer within six months, (b) prescribe certain factors to be omitted or included in the Commission's determination of avoidable cost and reasonable return on line for the purpose of determining the adequacy of a subsidization offer, (c) require that a petition to investigate be verified and be filed within 35 days after the filing of the application for abandonment or discontinuance, and (d) omit certain information from the revenue data to be submitted by a railroad in support of an application for abandonment or discontinuance. This court has jurisdiction under 28 U.S.C. §§ 2321 and 2342. We sustain challenges (a) and (b) and reject (c) and (d).

I

The Petition of the Railroads

In No. 76-2283 a group of railroads attack the provision permitting the Commission to postpone indefinitely the issuance of a certificate authorizing abandonment or discontinuance when a subsidization offer has been made but the railroad and the potential subsidizer fail to reach a financial assistance agreement within six months. They also challenge the regulations dealing with the determinations of "the avoidable cost of providing rail freight service on such line," and the "reasonable return on the value of such line," § 1a(6)(a)(ii)(A) and (7), insofar as these regulations (a) interpret the

[1] Section 1a, as amended on October 19, 1976, by the Rail Transportation and Improvement Act, Pub. L. No. 94-555, 90 Stat. 2628, is set forth in an appendix to this opinion.

term "current costs" in the statutory definition of "avoidable cost," § 1a(11)(a), to mean that portion of historical costs that are allocated to the current period; (b) limit "expenditures to eliminate deferred maintenance," § 1a(11)(a), to expenditures necessary to meet federal railroad administration safety standards for Class I track (safe at speeds up to 10 miles per hour); and (c) do not adequately allow for the difference between the cost of equity capital and the cost of debt capital or the effects of income taxes.

Background of the Statute

Inability to find relief from the burden of uneconomical branch lines was one of the problems of the Penn Central Transportation Company and other northeastern railroads that suffered financial disaster in the period preceding the 4-R Act. See *In re Penn Central Transportation Co.*, 382 F.Supp. 831, 836-837, 841 (E.D. Pa. 1974). A bankrupt railroad attempting to rid itself of such a line in a proceeding under 49 U.S.C. § 1(18)—(22), would find itself enmeshed in "drawn-out hearings before the Interstate Commerce Commission." *In re Reading Company*, 378 F.Supp. 474, 480 (E.D. Pa. 1974); see *In re Penn Central Transportation Co.*, 384 F.Supp. 895, 903 (Special Court 1974). Congress was acutely aware of this problem by reason of having subsidized the successor of these railroads, Consolidated Rail Corporation, in the years preceding the adoption of the 4-R Act.[2] The Senate Committee on Commerce, which, after holding hearings on the subject, originated the version of § 1a that was eventually enacted, recognized that the abandonment problem plagued the entire railroad industry, S. Rep. No. 94-499, 94th Cong., 1st Sess. 39-44 (1975), observing that "the regulatory

[2] Federal funds exceeding $680 million were provided in grants and loans in addition to millions in credit guarantees. Hearings on Railroad Amendments of 1976 Before the Subcommittee on Transportation and Commerce of the House Committee on Interstate and Foreign Commerce, 94th Cong., 2d Sess. 158-162 (1976).

climate constrained management's ability to . . . abandon obsolete properties and lines," and concluding that "the railroad industry should not be forced to continue to internalize all losses from branch line operations, thereby further jeopardizing the industry's already precarious economic health." *Id.* at 3, 44. Although the Congressional focus was primarily upon the abandonment problem, Congress recognized discontinuance of service as part of the same problem and treated it like abandonment in the statute.

When Congress had addressed the problem as it affected the northeastern lines in the Regional Rail Reorganization Act of 1973, Pub. L. 93-236, 87 Stat. 986,[3] it had prohibited abandonment or discontinuance when a potential subsidizer had offered a "continuation subsidy" covering the difference between revenues and avoidable cost plus a reasonable return attributable to the line or had offered to purchase the line. Section 304(c), 45 U.S.C. § 744(c). Instead of itself defining "avoidable cost" and "reasonable return," as it was to do three years later in the 4-R Act, Congress left them to be defined by the ICC's Rail Services Planning Office.[4] Section 205(d)(3), 45 U.S.C. § 715(d)(3).

As we shall see, significant departures from this approach were made in § 1a. That section provides that, when a "financially responsible person" makes a "continuation subsidy" offer that is likely to cover the difference between revenues and avoidable cost plus a reasonable return on line, abandonment or discontinuance is not flatly prohibited, but instead is postponed for a "reasonable time, not to exceed 6 months." The new statute not only itself defines the terms "avoidable cost" and "reasonable return" but defines them differently than did the Commission's Rail Services Planning Office under the 1973 Act. These and other provisions of § 1a pertinent to the consolidated reviews before us are discussed in connection with specific challenges to the regulations.

[3] That Act, as amended, appears in 45 U.S.C. § 701, *et seq.*

[4] The resulting regulations appear at 49 C.F.R. Part 1125.

The Statute

The 4-R Act repealed the abandonment and discontinuance provisions contained in § 1(18)—(22) of the Interstate Commerce Act and provided a new abandonment and discontinuance procedure in new § 1a. That section is to apply to railroads other than the northeastern railroads, which remain subject to the abandonment and discontinuance provisions of the 1973 Act, as amended by the 4-R Act. New § 1a establishes a procedure for Commission consideration of an application by a railroad for a certificate of abandonment or discontinuance. The Commission first decides whether the proposed abandonment or discontinuance is in the public interest. Upon a determination that it is, the Commission issues a certificate of abandonment or discontinuance, unless it finds that a financially responsible person has made an offer of financial assistance to enable the service to be continued that is likely to meet certain criteria. If it finds such an offer has been made, the Commission is to postpone issuance of the certificate for "a reasonable time, not to exceed 6 months" to permit the negotiation of a financial assistance or purchase and sale agreement between the railroad and the prospective subsidizer.

Paragraphs (1) through (5) of § 1a cover the procedure for considering and ruling on applications, except for the procedure relating to subsidization offers. Paragraph (1) provides that a railroad may not abandon a line or discontinue any service without first obtaining from the Commission a certificate declaring that the "present or future public convenience and necessity require or permit such abandonment or discontinuance." An application for a certificate must be submitted to the Commission, together with a notice of intent to abandon or discontinue, at least 60 days before the proposed effective date of the abandonment or discontinuance.[5] Paragraph (2) requires the railroad to give interested parties notice of its intent to abandon or discontinue.

[5] The application is to comply in matters of form, manner, content, and documentation, with rules and regulations that the Commission may prescribe.

Paragraph (3) provides that during the 60-day period between submission of the application and the proposed effective date the Commission may on its own initiative, and must upon petition, institute an investigation of the proposed abandonment or discontinuance. "If no such investigation is ordered, the Commission shall issue such a certificate, in accordance with this section, at the end of such 60-day period." If, however, an investigation is ordered, the Commission is to order a postponement of the proposed effective date "for such reasonable period of time as is necessary to complete such investigation."[6] Paragraph (4) provides that if a certificate is issued without an investigation, the abandonment or discontinuance may take effect 30 days after the certificate is issued. If an investigation is conducted, the Commission may issue the certificate as requested, issue it with modifications or subject to terms and conditions, or refuse to issue it. When a certificate is issued after an investigation, abandonment or discontinuance may take effect 120 days after the certificate is issued.[7]

Subsidization offers are dealt with in paragraphs (6) and (7) of § 1a. Under paragraph (6), when the Commission finds that the public convenience and necessity permit the abandonment or discontinuance, that finding is to be published in the Federal Register. A subsidization offer may then be made. In that event the Commission is to determine within 30 days of the publication in the Federal Register, whether the potential subsidizer[8] is financially responsible and whether the offer "is likely" to

[6] The investigation may include public hearings. The burden of proving public convenience and necessity are upon the applicant.

[7] Paragraph (5), which is not involved in this proceeding, provides in detail for the filing by each railroad of a transportation system diagram in accordance with regulations to be promulgated by the Commission. The diagrams are to show lines which are "potentially subject to abandonment" and lines as to which the railroad "plans to submit an application for a certificate of abandonment or discontinuance." Updating is required.

[8] In order to assist in the preparation of a subsidy offer, paragraph 6 requires the railroad to supply pertinent data to parties considering offering financial assistance.

> (A) cover the difference between the revenues which are attributable to such line of railroad and the avoidable cost of providing rail freight service on such line, together with a reasonable return on the value of such line; or
>
> (B) cover the acquisition cost of all or any portion of such line of railroad.

Upon an affirmative finding, the Commission "shall postpone" the issuance of the certificate "for such reasonable time, not to exceed 6 months," as is necessary to enable the potential subsidizer to enter into a binding subsidization agreement with the railroad. Paragraph (7) provides that when an offer of financial assistance has been made, the Commission is to

> determine the extent to which the avoidable cost of providing rail service plus a reasonable return on the value of the rail property involved exceed the revenues attributable to the line or railroad or the rail service involved.

The purpose of this determination is to enable the Commission to decide under paragraph (7) whether the offer is "likely" to cover the difference between revenues and "the avoidable cost." The terms "avoidable cost" and "reasonable return" are defined in paragraph (11) of § 1a.

The Commission's Order and Regulations

Following the adoption of the 4-R Act, the Commission issued a notice of proposed rule making and accompanying draft regulations on abandonment and discontinuance of rail service. 41 Fed. Reg. 31878 (1976). Interested persons were given an opportunity to submit written statements. Railroad interests, the United States Department of Transportation, and other interested parties submitted statements. In November 1976 the Commission adopted the regulations that are at issue in this proceeding and issued an explanatory Report. In May 1977, in response to various petitions for reconsideration, the Commission made a few minor revisions in the regulations and issued a Report on Reconsideration explaining its action.

The regulations are divided into four subparts. Subpart A consists of a general statement of purpose and definitions. Subpart B implements the diagram requirements of paragraph (5) of § 1a, which are not involved here. See note 7, *supra*. Subpart C prescribes procedures for filing and processing applications for abandonment or discontinuance, making offers of financial assistance and conversion of abandoned rail properties to other public uses (provided for in paragraph (10) of § 1a). Subpart D contains standards for determining revenues attributable to a line that is the subject of an abandonment or discontinuance application, avoidable cost of providing service over the line, and reasonable return on the value of the line. The regulations that are challenged appear in subparts C and D.

A. *Indefinite Postponement of Issuance of Certificate*

The railroads first challenge the provision of the regulations that allows the Commission to postpone the issuance of a certificate indefinitely if a subsidization offer is received and the railroad and the potential subsidizer fail to reach a financial assistance agreement within 6 months. Section 1121.38(i)(2). They contend that this provision is contrary to paragraph (6)(a) of § 1a, which provides that if the commission mades the requisite finding with respect to a subsidization offer, it

> shall postpone the issuance of a certificate of abandonment or discontinuance for such reasonable time, not to exceed 6 months, as is necessary to enable such person or entity to enter into a binding agreement, with the carrier seeking such abandonment or discontinuance . . . .

The challenged regulation provides that, if the parties are unable to reach agreement during the six-month period, the Commission may take one of the following actions:

> (i) Issue a final certificate at the end of the 6-month period . . .,
>
> (ii) Reopen the underlying abandonment or discontinuance proceeding to reevaluate the application on its merits in light of the financial assistance offer;
>
> (iii) Direct the carrier to continue to provide rail freight service for an additional year in return for compensation to be computed by the Commission [in accordance with certain standards] . . . or
>
> (iv) Take whatever action is appropriate in the particular situation and in conformity with section 1a of the Act. Such action may include but not be limited to setting the matter for arbitration subject to the final review of the Commission.

Section 1121.38(i)(2).

The railroads argue that only the first of these four options is authorized by § 1a of the Act, because paragraph (6) of that section permits postponement of the issuance of the certificate for only six months. The Department of Justice has filed a brief making the same argument. The Commission's position is that the provision "is necessary to effectuate the intent of Congress that every opportunity be afforded to preserve rail service, especially if a potential subsidizer or purchaser has made a reasonable offer of assistance," as it says in its Report, and that a refusal by the railroad to accept a reasonable subsidy offer constitutes "substantially changed circumstances" within the meaning of § 17(9)(g) of the Interstate Commerce Act, which permits reopening of a Commission decision, including one under § 1a, upon "material error, new evidence or substantially changed circumstances."

Paragraph (6) of § 1a states that the postponement of the issuance of a certificate is "not to exceed 6 months." We do not know how Congress could have made it any plainer. If there were any doubt, a comparison could be made between paragraph (6) and an earlier paragraph of § 1a that also gives the Commission postponement authority, paragraph (3). The words used for that purpose are the same in the two paragraphs, except that in paragraph (6) the phrase "not to exceed 6

months" is included. The Commission would have us read "for such reasonable period of time as is necessary," appearing in paragraph (3), and "for such reasonable period of time, not to exceed 6 months, as is necessary," appearing in paragraph (6), as meaning the same thing. This we decline to do.[9]

Nor can the existence of an impasse in subsidy negotiations constitute "substantially changed circumstances" within the meaning of § 17(9)(g) of the Act. The Commission's determination of whether abandonment is consistent with the public convenience and necessity is made before any consideration of a subsidy offer and without regard to whether a subsidy may be available. The regulations themselves state, in § 1121.38(h)(3):

> The Commission shall not consider an offer of financial assistance or any resulting agreement in making its initial finding on the merits of abandonment or discontinuance application[s].

[9] We note that acting ICC Chairman Charles Klapp recognized that the language of the statute means what it says when, in testifying before a subcommittee of Congress in June 1976, he stated that an amendment to § 1a(6) he was supporting

> . . . by removing the phrase "not to exceed 6 months," gives the Commission the discretion to extend for a longer period of time the issuance of an abandonment certificate if the circumstances of a particular case make such an additional extension reasonable. This amendment addresses the very real problem of a railroad simply refusing to negotiate in good faith for the statutory 6-month period and thus successfully preventing the making of a subsidy agreement.

His amendment would have given the Commission authority to extend the negotiating period but to prescribe terms for continued operation if no subsidy agreement was reached within six months. Hearings on Rail Amendments of 1976 Before the House Subcommittee on Transportation and Commerce of the House Committee on Interstate and Foreign Commerce, 94th Cong., 2d Sess. 48 (1976). Congress did not accept Chairman Klapp's proposal and was presumably not persuaded by his policy argument.

If the availability of a subsidy cannot properly be considered by the Commission in its initial abandonment or discontinuance decision, it can hardly be a "changed circumstance" justifying reopening of that decision.

No doubt, as the Commission argues, the provisions for subsidization were intended to provide a reasonable opportunity for the salvaging of service. What is a reasonable time, however, was for Congress to decide in light of its apparent determination to grant relief from the prolonged administrative proceedings that had attended abandonment and discontinuance.

In the 1973 Act Congress flatly prohibited the issuance of a certificate so long as a reasonable subsidy offer was outstanding. 45 U.S.C. § 744(c). The 4-R Act, which, it will be recalled, left the northeastern lines still subject to the 1973 Act, preserved that prohibition and added a provision, 45 U.S.C. § 744(d), giving such a railroad applying for an abandonment or discontinuance certificate the right to refuse to enter into a subsidy agreement only when the Commission determines "on petition by any affected party" that the subsidy agreement would "substantially impair" the railroad's ability to meet its existing obligations. The omission of a similar cram-down provision in § 1a confirms our interpretation of the "not to exceed 6 months" limitation.

B. *Avoidable Cost and Return on Line*

The railroads' second challenge to the regulations concerns the standards for determining avoidable cost and reasonable return on line for purposes of the Commission's determination under § 1a(6)(a)(ii) and (7) of whether the offered financial assistance is adequate.

1. *"Current Cost" of Equipment*

The first issue is whether in determining avoidable cost the depreciation cost for locomotives, freight cars, and other equipment attributable to branch line service should be based on (a) the original or book cost of that equipment or (b) the cost that would be avoided if the service were terminated and the equipment used else-

where on the railroad, *i.e.*, the cost of purchasing new equipment.

An oversimplified illustration may be useful: Assume that at the beginning of the subsidy year in question[10] a locomotive used only in branch line service that cost $90,000 has been used for 29 of its 30 years of useful life and has been depreciated on a straight-line basis. It will be depreciated the final $3,000 in its 30th year of service. If branch line service continues for that year and the locomotive is needed on the branch, the railroad will be required to purchase a new locomotive for use on the main line. It will cost $600,000, also have a 30-year useful life, and be depreciated at the rate of $20,000 per year. If branch line service is discontinued now, the railroad can use the old locomotive on the main line for its final year of useful life and postpone purchasing a new one, so the increment to depreciation of the main line equipment that year will be $3,000 instead of $20,000. Therefore, if branch line service is continued, depreciation costs for total service provided by the railroad will be increased by $20,000.

Under alternative (a) above, which does not take into consideration the systemwide increase in depreciation costs, the avoidable cost is only $3,000, the book cost of the locomotive utilized on the branch line. Under alternative (b), the avoidable cost is $20,000, because that is the increased depreciation cost that the railroad will incur if branch line service is continued.

The regional standards adopted by the Commission under the 1973 Act, which left it to the Commission's Rail Services Planning Office to define avoidable cost, chose alternative (a). 49 C.F.R. § 1125.5(5). The new regulations issued under the 4-R Act admittedly are

[10] Under § 1121.46 of the regulations subsidy payments are adjusted every year. These adjustments would compensate the railroad for the depreciation costs of equipment purchased in order to provide continued branch line service to the extent that such requirement is actually part of branch line operations. See §§ 1121.42(c)(4) and 1121.42(m).

based on those regional standards[11] and refer to book cost. Sections 1121.42(c)(4) and 1121.42(m).

The 4-R Act, however, contained its own definition of avoidable cost: "all expenses which would be incurred by a carrier in providing a service which would not be incurred" if the line were not abandoned or the service not discontinued, including "all cash outflows which are incurred" absent the abandonment or discontinuance, which in turn includes, *inter alia*, "the current cost of freight cars, locomotives and other equipment." Section 1a(11)(a).

Relying heavily on the word "incurred," the Commission argues that "current cost" means the portion of historical cost allocable during the subsidy year in question to the branch line or service that is the subject of the application. The railroads, of course, rely on the literal meaning of "current cost," as well as the context and legislative history. We think the railroads have the better of the argument. The natural meaning of the words used, "the current cost" of equipment "which would be incurred . . . in providing a service" but "would not be incurred" if the service were not provided, seems to us to be the actual present dollar saving that would result from discontinuance or abandonment.

This view is supported by the legislative history. During 1975 the Senate conducted hearings on various aspects of national railroad policy. Railroads—1975, Hearings Before The Senate Committee on Commerce, 94th Cong., 1st Sess. (1975) (cited hereinafter as "Hearings"). These hearings included consideration of some 15 bills pertaining to branch line service. Hearings 657-658. One of these, S. 863, contained amendments to the then existing abandonment provisions contained in § 1(18)—(22) of the Interstate Commerce Act. It pro-

[11] In its Report on Reconsideration the Commission stated:

> [W]e believe the congressional intent is that the national standards should follow the conceptual approach of the regional standards. Consequently, the regional standards are being used to provide the foundation upon which the national standards are based.

posed a subsidy provision (proposed new § 1(27)(A), Hearings 268-269) that would have given the Interstate Commerce Commission power to postpone the issuance of an abandonment certificate for a period not to exceed 90 days, once a subsidy offer had been made that covered the difference between revenue and avoidable costs plus a reasonable return on the value of rail properties. The 90-day extension was provided to permit a subsidy plan to be worked out. The terms "avoidable cost" and "reasonable return" were defined as they were under the 1973 Act by the Commission's Rail Services Planning Office. (Proposed new § 1(22)(E), Hearings 263-264.)

Appearing as a witness on behalf of the railroads at those hearings was one J. H. Williams, whose testimony seems to have been taken seriously by the Committee[12] and, as we shall see, influenced the Senate's contribution to what eventually became § 1a. Williams contended that a subsidy offer under S. 863 would not adequately compensate a railroad for continuing branch line service because of deficiencies in RSPO's regulations adopted under the 1973 Act. He criticized these regulations for, among other things, adopting a historical cost standard for determining avoidable locomotive and freight car ownership costs (depreciation) and urged that "avoided acquisition (or 'purchase new') costs is the correct measure of the avoidable cost of equipment ownership."[13] Williams recommended that the proposed

[12] J. H. Williams was Manager of the Bureau of Transportation Research of Southern Pacific Transportation Company. Senator Hartke, presiding at the time, called him "one of the bright minds of this business." Hearings 800.

[13] He said.

> The most likely effect of abandonment would be that rolling stock released from serving a light density line's traffic would displace purchases of new rolling stock of similar kind and capacity. To illustrate, if 50 freight cars and one locomotive were required in order to provide subsidized light density line service, cessation of that service would permit the operating carrier to avoid the purchase of 50 new freight cars and one new locomotive. Thus, the calculation of depreciation based on these avoided acquisition (or "purchase new") costs is the correct measure of the avoidable cost of equipment ownership.

Hearings 800.

new § 1(27)(A) be amended to replace the avoidable cost standard with a fully allocated cost standard.[14] Hearings 807. This proposal was adopted by the Senate in the bill that was to become the 4-R Act, S. 2718, but was ultimately rejected by the Senate-House Conferees in favor of the avoidable cost standard.

Williams recommended that the Commission publish not only new standards for determining fully allocated costs but also new standards governing the determination of reasonable return on line. Hearings 807. An allowance for income taxes, he proposed, should be made in the return calculation by adjusting the rate of return, which he defined as the opportunity cost of capital. In addition, he proposed that the investment base upon which return is calculated should include "all cash inflows which are foregone and all cash outflows which are required . . . as a result of continued operation of the line segment . . . and . . . shall include . . . the tax benefit from retirement; *the current cost of freight cars and locomotives;* working capital; required capital expenditures; and expenditures to eliminate deferred maintenance." *Id.* (Emphasis supplied.)

The language of Williams' proposed amendment ultimately found its way into the definition, not of reasonable return on line, but of avoidable costs in the 4-R Act Congress enacted. The tortuous route by which it did so was as follows: At the conclusion of the Senate Hearings, S. 2718 was introduced and, as noted above, was subsequently amended and enacted as the 4-R Act. That bill included what became, after amendments, § 1a. Also, as noted above, the initial version of § 1a embraced, for subsidy purposes, Williams' fully allocated

[14] Williams reasoned as follows:

> To the extent publicly subsidized traffic makes no contribution to a carrier's overhead and fair rate of return on its off-branch property, other traffic must bear this entire burden. From the standpoint of treating all rail users equitably, therefore, the relevant cost standard to be used in calculating branch line subsidies should be fully allocated costs.

Hearings 805.

cost standard instead of the avoidable cost standard. It did not contain, however, any definition of fully allocated cost or of reasonable return on line. S. Rep. No. 94-499, 94th Cong., 1st Sess. 291 (1975). The House passed H.R. 10979 as an amendment to S. 2718 and in so doing deleted the proposed new § 1a in its entirety, thus omitting any provision for a continuation subsidy. H. R. Rep. No. 94-725, 94th Cong., 1st Sess. 16-17 (1975). The Senate-House Conferees agreed to restore § 1a, including its subsidy provisions, but substituted the avoidable cost standard for the fully allocated cost standard and added definitions of avoidable cost and reasonable return on line. The definition of avoidable cost used the language of, and was plainly drawn from, Williams' proposed amendment relating to the investment base on which reasonable return on line would be calculated. Williams' proposed language, "the current cost of freight cars and locomotives," became "the current cost of freight cars, locomotives and other equipment" in § 1a(11)(a).[15] Williams had used this language to describe cash spent "to acquire freight cars and locomotives—which the railroad would avoid if the abandonment occurred." Hearings 805-806. In the context of avoidable cost, then, the "current cost of freight cars, locomotives and equipment" would mean the acquisition costs (currently allocable as depreciation) of freight cars, locomotives, and other equipment incurred because of having to continue branch line service.

[15] The conference substitute was subsequently modified, but the quoted language remained unchanged. After initially passing the conference substitute, both Houses rescinded that action and resubmitted the matter to the Committee on Conference. S. Rep. No. 94-595, 94th Cong., 1st Sess. 133 (1976). The version of § 1a which was finally adopted, S. Rep. No. 94-595, *supra* at 106-109, made these changes: The original conference substitute included in the definition of avoidable cost the reasonable rate of return on the salvage value of the railroad's properties. This element was deleted. Also, the original conference substitute's definition of reasonable return was simply the railroad's cost of capital. This definition was expanded by providing different standards for computing the rate of return for railroads in reorganization and those not in reorganization. Compare S. Rep. No. 94-585, 94th Cong., 1st Sess. 98 (1975) with S. Rep. No. 94-595, *supra* at 109.

One more significant event concludes this history of the "current cost" phrase and the compromise that brought it into the Act: a House Amendment to § 1a that would have defined avoidable cost as having the meaning given to the term under the 1973 Act was rejected. S. Rep. No. 94-595, 94th Cong., 1st Sess. 219 (1976).

Congress might have chosen, as a matter of policy, to allocate to the branch line for subsidy purposes those depreciation costs that would have been allocated to that line if the service had continued on an unsubsidized basis. Consistent application of this approach would also seem to require allocation to the branch line of its share of systemwide fixed costs, which Congress clearly decided not to do when, as a result of the conference compromise, the Senate version of § 1a, containing a fully allocated cost standard, gave way to an avoidable cost standard. But, as part of the compromise, avoidable cost was redefined to include, *inter alia*, "the current cost of freight cars, locomotives and other equipment." The effect of this was to require that the subsidy cover, not the branch line's share of systemwide fixed costs that accounting theory might call for, but the more practical actual dollar difference between the railroad's systemwide variable depreciation costs if the service is continued and the systemwide variable depreciation costs if the service is discontinued.[16]

The dissent argues that the result of our interpretation is that, in the illustration given above, "the railroad receives an effective depreciation value of $37,000." This figure, as we understand it, is made up of the $20,000 portion of the cost of the new locomotive allocable to the year in question, which the railroad takes as depreciation, and a "subsidy bonus" of $17,000 that is said to

[16] In our example above, by purchasing the new locomotive to continue branch line service the railroad would incur a capital cost, in addition to a depreciation cost. The language "current cost of freight cars, locomotives and other equipment" in § 1a(11)(a) refers to depreciation cost ("incurred outflows"). The capital cost is a part of "all expenses incurred." See Part I. B. 3, *infra*.

result from "plac[ing] a replacement cost value on the 29-year old car being used on the branch line." With respect, the $17,000 is not an element of "depreciation value." The total systemwide "depreciation value" is the $20,000 for the first year of the new locomotive plus $3,000 for the 30th year of the old locomotive. The dissent's additional $17,000 is, if anything, the presumed intangible value to the railroad of being able to use a new locomotive on its main line instead of the old one it would have used if the branch line service had been discontinued.

If branch line service were discontinued, the depreciation costs of $23,000 would be decreased by $20,000, because the railroad would use the old locomotive on the main line instead of buying a new locomotive. The question is whether the subsidizer will pay the entire $20,000 or only $3,000. We think the language used by Congress means the subsidizer is to pay the entire $20,000.[17]

2. *"Expenditures to Eliminate Deferred Maintenance"*

The railroads also challenge the Commission's interpretation of the words, "expenditures to eliminate deferred maintenance," which also appear in the statutory definition of avoidable cost. Again, notwithstanding the new statutory language, the Commission followed its regulations under the 1973 Act, this time merely adopting verbatim the language of those regulations. Section 1121.42(b) of the new regulations provides that rehabilitation costs are not to be included unless

[17] We do not understand the dissent to be saying that the reason the perceived windfall occurs is that the railroads receive a tax benefit when the depreciation cost of newly acquired equipment is applied against revenues to decrease taxable income. If that were a reason for excluding the systemwide increased depreciation cost, it would also be a reason for denying subsidy compensation not only for depreciation costs however determined, but for all expenses incurred by continuing branch line service. We express no opinion on the appropriate treatment of the tax effects of allowing replacement costs for subsidy purposes, because that question has not been argued by the parties.

> (A) the track involved does not meet minimum Federal Railroad Administration (FRA) Class I safety standards (49 CFR 213) . . .; or (B) the potential subsidizer requests a level of service which requires expenditures for rehabilitation.

With respect to (A), FRA Class I safety standards are satisfied if the track is safe for operating speeds of 10 miles per hour or lower. 49 C.F.R. § 213.9. Yet operations at that speed may be so inefficient a use of equipment, personnel, and fuel that rehabilitation to a higher level is a practical necessity if service is to continue. Clause (B) does not solve this problem, because it refers to the level of service the potential subsidizer requests, not the level or kind of service that would meet standards of efficient operation.

It seems to us unlikely that Congress would have contemplated the operation of trains at 10 miles per hour or less in subsidized operations. Also unlikely is the possibility that Congress chose such an oblique way of requiring the railroads to pay the difference between the subsidy and the cost of operating trains at efficient speeds. The financial inability of the railroads to maintain their lines adequately, especially uneconomical branch lines, and the consequent accumulation of deferred maintenance were made known to Congress in the hearings on the 4-R legislation, Hearings 659, and the need to remedy the problem was noted in the Act itself. Section 101(a), 90 Stat. 33, 45 U.S.C. § 801(a). We decline to attribute to Congress some kind of devious undisclosed intent to qualify drastically what on its face is a straightforward direction that the railroads' deferred maintenance cost be included in avoidable cost for purposes of the Commission's evaluation of a subsidization offer. The challenged regulation is contrary to that direction and is therefore invalid.

3. *Cost of Equity Capital in Determining Return on Equipment*

The Commission recognizes that the term "avoidable cost," as defined by Congress, encompasses capital costs

as well as operating expenses.[18] Accordingly, the Commission provided for a return on investment in locomotives, § 1121.42(c)(6), and freight cars, § 1121.42(*l*)(3), as an increment of avoidable cost.[19] The rate of return used in computing the return on investment for both locomotives and freight cars is "the rate of interest which apply to the latest equipment trust certificates, conditional sales agreements or equipment lease agreements entered into by the railroad" to purchase or lease new locomotives and freight cars. Sections 1121.42(c)(6)(iv) and 1121.42(*l*)(3).

Thus, although both debt and equity capital are invested in locomotives and freight cars, the regulations provide a single rate of return based on the cost of debt capital. The Commission recognizes in its brief and in

[18] Thus the investment in locomotives and freight cars is not included in the investment base on which return on line is calculated. The return on line element of the subsidy payment is dealt with in § 1121.44 (entitled "Reasonable Return"). Paragraph (c) of that section provides that the return element is to be computed by applying the railroad's rate of return as established in paragraphs (a) or (b) of the section to the value of the branch line as calculated according to § 1121.43 (entitled "Valuation of Rail Properties"). The latter section includes (a) working capital (the excess of current assets over current liabilities), (b) "current income tax benefits resulting from abandonment of the line which would have been applicable to the period of the subsidy agreement," and (c) the net liquidation value "of the railroad properties on the line to be subsidized which are used and required for performance of the services requested by the person offering the subsidy." It does not include investment in locomotives and freight cars.

[19] Section 1121.42 is entitled "Avoidable Costs of Providing Service." Paragraph (c) of that section is entitled "Maintenance of Equipment," and subparagraph (6), entitled "Return on Investment—Locomotives," prescribes how the return on investment in locomotives is to be calculated and apportioned between the branch and the rest of the system. Paragraph (*l*) is entitled "Freight train car costs" and subparagraphs (3) and (5) prescribe how the return on investment in freight cars is to be included in computing on-branch freight car costs.

its Report[20] that the railroads should be compensated for their cost of equity capital but states that the railroads have failed to propose a specific method of measuring that cost.[21] It attempts to justify its reliance solely on the cost of debt capital by arguing that its regulations do provide an "effective return" on equity capital while at the same time promoting administrative convenience.[22]

[20] The Commission's Report states,

> [T]he railroad should receive a return on the equity in its rolling stock. The proposed standards were not intended to exclude such a return. The standards apply to the entire net equipment investment the same rate of return, in the belief that this would have the advantage of simplicity and minimize paper work. However, inasmuch as the rate specified is the interest rate applicable to the carrier's most recent equipment obligations, rather than the average yield on all such outstanding obligations, and the carrier's actual interest payments are deducted before computing taxable income, the result of this process would be an effective return on the equity portion of the equipment investment substantially higher than this over-all rate.

Elsewhere in its Report, the Commission, in referring to cost of capital invested in line (see § 1a(11)(b)), said

> [S]ection 1a(11)(b) of the Act clearly envisages that the Commission shall determine the cost of capital for each railroad not in reorganization whenever an offer of subsidy is made, and that determination should include appropriate consideration of all elements, including debt and equity.

[21] The Commission's Report states,

> AAR objects that these proposed standards fail to allow the operating carrier to recover its full cost of capital for rolling stock by providing only for interest on debt and not equity. It proposes no specific alternative . . . .

And, later the Report states,

> If any party believes that separate rates of return for the debt and equity portions of the equipment investment are desirable, and is able to propose and substantiate a reasonable basis for computing such separate rates, subsequent revision of the standards to accomplish this could be considered.

[22] See note 20.

Neither convenience nor the failure of the railroads to propose a specific method of measuring the cost of equity capital is a justification for the Commission's failure to develop and adopt a standard consistent with the Congressional intent or for us to sustain a regulation we find to be inconsistent with the statute. Congress gave the Commission and not the railroads the responsibility of developing regulations that would carry out the purposes of the statute. We note that for purposes of another provision of the 4-R Act, § 212, 49 U.S.C. § 1(14)(a), the Commission has been able to devise a method of determining the cost of equity capital. See *Report of Commission, Car Service Compensation—Basic Per Diem Charges—Formula Revision in Accordance with the Railroads' Revitalization and Regulatory Reform Act of 1976, Ex Parte* No. 334, pp. 29-70 (August 1, 1977).[23]

As for the Commission's assertion that measuring the entire return by the cost of debt capital gives the railroad an "effective return" on the cost of equity capital, we are not persuaded. Unless, by coincidence in a particular instance, a reasonable return on debt capital is exactly equal to what a reasonable return on equity capital would be if allowed, either the railroad or the potential subsidizer will be unfairly treated under the Commission's regulations.

[23] In the course of its decision in that matter the Commission stated as follows:

> The Commission interprets the 4-R Act as requiring the current cost of the overall capital structure. This negates reliance on the debt instruments and direct cash outlays specific to a given car, but requires consideration of the entire capital structure from a current point of view. (P. 35.)
>
> Debt and equity are independent of each other in arriving at their respective costs. Debt cost is merely the interest rate paid on the debt contracts. Equity cost is the premium that must be paid to attract investor's funds. (P. 49.)
>
> In a well-managed on-going concern, the cost of equity is determined by the price tag, expressed as a combination of expected dividends and market appreciation of common stock, set on equity funds by the investor. This cost of equity is then included as a component of the cost of capital. (P. 50.)
>
> Given the unique cost and risk characteristics of equity, it would be erroneous and illogical to tie equity costs to debt interest rates with some fixed percentage relationship. Rather, debt and equity cost components must be calculated separately then brought together in a weight [sic] average. (P. 67.)

The regulations are therefore invalid insofar as they disregard the different costs of equity and debt capital in providing for the determination of permitted return on investment in locomotives and freight cars.

Another argument is raised obliquely by the railroads. They argue that, in determining avoidable cost, the return on investment in the railroads' existing fleet of locomotives and freight cars should be based on replacement cost. This argument has two facets: (1) The rates of return should be the current debt and equity rates, rates "which would have to be incurred to buy new cars and locomotives—costs which could be avoided if the branch line were abandoned or service discontinued;" thus (2) the investment base upon which the return is calculated should not be the book cost, as the regulations provide,[24] but the replacement cost. The railroads' position on these points is stated in the course of arguing in their brief that the rate of return on equipment should reflect the cost of equity capital as well as the cost of debt capital.[25] They do not develop

[24] In calculating return on investment in locomotives, the investment base is the gross investment in existing equipment less accrued depreciation and amortization, § 1121.42(c)(6)(ii). In calculating return on investment in freight cars, the investment base is derived from Rail Form A, which uses book cost.

[25] The investment base facet of the argument is raised in a footnote in the railroads' brief in which they take issue with an example in the Commission's Report professing to show that its regulations, by using the cost of debt capital incurred by the railroad in its most recent equipment acquisitions, effectively return to the railroad its cost of equity capital. In the footnote the railroads dispute that the regulations do in fact provide a return on the equity portion of investment, in part relying on the fact that the correct investment base upon which the return on investment in locomotives and freight cars should be calculated is replacement cost.

this extension of the replacement cost position to any extent, do not even include it in the summary of the argument for the part of their brief in which it appears, and did not mention it in oral argument. In dealing with this matter in the Report, the Commission stated as follows:

> (b) *Equipment investment base.* The investment base to which the allowable return is applied flows from the computation of original cost less accrued depreciation. DOT states it has petitioned the Commission to institute a proceeding to evaluate the basis of valuing assets. In effect, it appears to favor the cost of reproduction new less depreciation as the basis for valuing assets, a position seemingly at variance with its views in Ex Parte No. 293, Sub No. 2. It concedes that such a change would require a change in the cost of capital standard, so that the inflation factor would not be reflected twice.
>
> DOT's proposal for valuing assets would have far-reaching consequences; we believe that it would be more appropriately considered in a general proceeding involving all users of rail service, rather than a rulemaking proceeding limited to the prescription of branch line abandonment and subsidy standards.

Because the matter is not squarely raised by the railroads or adequately discussed in any of the briefs and is still apparently open before the Commission, it would be inappropriate for us to rule upon it at this time. Apparently the Commission contemplates an examination of the matter in greater depth "in a general proceeding involving all users of rail service." We are not advised whether such a proceeding has been instituted or is in the offing. In any event, the Commission will be reexamining the pertinent sections of the regulations before us in view of our ruling with respect to the rate of return. If the railroads are dissatisfied with the result, they can challenge the Commission's new regulations by another petition for review.

4. *Cost of Capital for Railroads in Reorganization*

The Commission again ignored the differing costs of equity and debt capital in its regulations governing the determination of reasonable return on the value of the branch line for railroads in reorganization. Section 1a(11)(b) of the statute defines "reasonable return" for a railroad in reorganization as "the mean cost of capital of railroads not in reorganization." The regulations, on the other hand, in § 1121.44(b), provide that the "reasonable return" of a railroad in reorganization shall "be the average yield on all railroad bonds for the week immediately preceding the execution of the subsidy agreement, as quoted by any standard investors' service . . . ."[26] In its report, the Commission admits that "reliance on average railroad bond yield is an imperfect method for accomplishing Congressional intent," but states that it had "no better data on which to base the standard," and when better data is acquired the standard can be revised.[27]

Here, as in the case of the standard for determining the cost of capital of railroads not in reorganization, the Commission is not free to throw up its hands and disregard Congress' direction simply because it finds it difficult to perform the task Congress has set for it. The regulations are invalid insofar as they exclude the cost of equity capital for railroads in reorganization.

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[26] The Commission has again persisted in an approach it employed under the 1973 Act. Its regulations under that Act provide that "[t]he reasonable return on the value of rail properties . . . shall be the interest rate that is equal to the publicly quoted yield . . . for United States Treasury bonds or notes." 49 C.F.R. § 1125.7. It was pointed out by witness Williams in the hearings that this method of determining capital costs did not reflect the true costs of capital to the trustees of the bankrupt carriers. Hearings 800-801.

[27] The Commission also states,

> In the near future, only one railroad would be affected by this standard, and it seems undesirable to place upon it, or upon persons offering to subsidize its branch lines, the burden of establishing the "mean cost of capital of railroads not in reorganization" which apparently AAR cannot presently supply.

5. *Effect of Income Taxes*

The railroads also assert that the Commission's failure to allow consideration of the cost of equity capital in determining return permitted on locomotives and freight cars and return permitted to carriers in reorganization is compounded by the failure to provide for consideration of the effects of income taxes upon the return on equity.

The railroads' first complaint is that the regulations, in providing for the determination of the return on investment in locomotives and freight cars as an increment of avoidable cost,[28] fail adequately to take into account the effects of income taxes on the return on equity capital. They rely upon paragraph 11(a) of § 1a, which defines "avoidable cost" of branch line service and is applicable to return on investment in locomotives and freight cars because of the classification of that return as an increment of avoidable cost. That definition includes

> (iv) the foregone tax benefits from not retiring properties from rail service and *other effects of applicable Federal and State income taxes.*

(Emphasis supplied.) Indisputably, the regulations fail to comply with this requirement. The Commission offers no explanation of why, and does not even mention this point in its brief. The railroads suggest that the Commission can meet its obligations under § 1a by either treating taxes on the return on equity capital as a separate expense or by properly adjusting the rate of return on equity capital. The Commission's attempts to allow for the effects of income taxes in computing the return on line for a railroad in reorganization, brings us to the railroads' second point.

They complain that even though the regulations make allowances for income taxes in computing the return on line for railroads in reorganization (§§ 1121.44(b) and (c)) they still fail adequately to take account of the effects of income taxes on the return on equity capital. We have held that § 1121.44(b) is invalid insofar as it does not reflect the cost of equity capital to

[28] See notes 18 and 19 and accompanying text.

railroads in reorganization. To the extent that it does not, *a fortiori*, any attempt to adjust the return for railroads in reorganization to allow for the effects of income taxes could not allow for the effects of income taxes on the return on equity capital. Again the Commission utterly ignores this point in its brief.

The railroads' position with respect to the effects of income taxes appears to have substance. Yet the Commission's position may have a basis of which we are not aware. Since the Commission has not so far deigned to mention the tax effects issues raised by the railroads, either in its brief or Report, and the regulations must be remanded for other reasons in any event, the Commission should reconsider this aspect of the regulations. If it adheres to its present position, it should explain why it believes its regulations are consistent with the Act, so they can be intelligently reviewed by a court.

A final footnote at the end of the railroads' brief is addressed to an adjustment in return on line, which is not mentioned elsewhere. It is said that the adjustment that § 1121.44(c) of the regulations allows in the return on the equity portion of the investment on line is inadequate, because using the "current (cash) effective" tax rate for the overall operations of the railroad would reflect tax effects attributable to non-branch line operations and thus cause the branch costs to be subsidized in part by the other operations of the railroad. The Commission, having made no response to this seemingly plausible criticism, should reconsider this aspect of the regulations on remand and, if it adheres to its present position, explain its reasons.

II

The Petition of American Railway Supervisors' Association, et al.

In No. 77-1008 national labor organizations which represent employees in the railroad industry attack as contrary to § 1a the requirements of the regulations that a petition to investigate be verified, § 1121.36(a)(1), and "be filed with the Commission within 35 days of the fil-

ing with the Commission of an abandonment or discontinuance application." § 1121.36(c)(1).

The reason for the verification requirement is explained by the Commission in its Report on Reconsideration as follows:

> [T]he requirement for verification is the least restrictive precaution to the filing of frivolous petitions . . . . Since we do not believe Congress intended an investigation to be conducted on the basis of frivolous petitions, the verification requirement is necessary to establish the legitimacy of the petition and to promote the expeditious handling of abandonment proceedings.

The labor organizations do not question the assumption concerning Congress' intention as to frivolous petitions that underlies the requirement of verification. We believe it was within the Commission's broad administrative discretion in procedural matters, *see, e.g., Federal Communications Commission v. Shreiber Co.*, 381 U.S. 279, 289 (1965), to impose the requirement.[29]

As to the time limit, the argument is that Congress, having allowed 55 days (60 days less five days for service on the carrier) for the Commission to order an investigation, must have contemplated that prospective petitioners would have that long to petition. We think that the Commission, in the exercise of its broad discretion to regulate procedure, may impose requirements as to the information to be contained in a petition to investigate in order to assure that the petition is not frivolous and to facilitate and expedite the investigation. For the same reasons, it may provide for a reply by the railroad. Thirty five days is not an unreasonable time for the filing of a petition to investigate, considering the Commission's rejection of suggestions that the petitioner be required to submit detailed information and the fact that a four-month warning that an application for abandonment or discontinuance will be filed must, under § 1a(5)(b) of the Act, be given by way of a system diagram.

[29] It is to be noted that the regulations also require that petitions for abandonment or discontinuance be verified by an officer of the carrier, § 1121.32(j), and that replies to a petition for investigation shall be verified, § 1121.36(c)(4).

The objections advanced by the labor organizations are without merit. Section 1126.36 of the regulations is valid.

III

The Petition of the State of Pennsylvania

In No. 77-1487 the Commonwealth of Pennsylvania challenges the regulations prescribing the revenue data to be submitted by a railroad in an application for abandonment or discontinuance, § 1121.32(d) (which refers to §§ 1121.41-1121.45), because they do not require the information that would be needed for the application of the so-called "50 percent rule," and thus impliedly repudiate that rule. The 50 percent rule is nowhere contained in previous regulations on abandonment applications. It is a product of the consideration of abandonment applications by the Interstate Commerce Commission and is a method of determining, for abandonment purposes, the costs of services beyond the limits of the branch for freight movements which are in part over the branch and in part on lines beyond the branch.

The rule operated as follows: The railroad would submit with its abandonment application data showing revenues in each of three categories:

(1) freight moving between points on the line;

(2) freight moving between a point on the line and a point beyond the line; and

(3) bridge traffic, *i.e.*, freight operating at a point off the line and moving over the line en route to a destination beyond the line.

The revenues in categories (2) and (3) were divided into on-line and off-line subcategories, usually on a mileage prorated basis. See §§ 1121.1(m) and (n)(1)(i) (1976). The "avoidable cost" for the branch line was then calculated, and 50 per cent of the beyond-line revenue was taken as the cost of beyond-line service.

The provisions of which Pennsylvania complains provide for lumping together in one category the revenues from categories (1) and (2), with bridge traffic revenue being a second category. Sections 1121.32(d) and 1121.45. This means the 50 percent rule will not be used in the future.

The 50 percent rule apparently was first used (the railroad respondent-intervenors so advise us), in *Chicago & North Western Ry. Co. Trustee Abandonment*, 230 I.C.C. 645 (1939).[30] In that and subsequent cases it has been described, not as an unvarying standard to be used in all cases, but as a reasonable method of estimating off-branch costs in the absence of a better method. *Id.* at 652-653; *Chicago & North Western Co. Abandonment*, 275 I.C.C. 759, 775 (1951); *New York, N. H. & H. R.R. Abandonment*, 324 I.C.C. 345, 350 (1965); *Baltimore & Ohio R.R. Abandonment—Landenburg Branch*, 354 I.C.C. 67, 74 (1977). In the latter case, the abandonment proceeding had been initiated prior to the 4-R Act so the regulations before us were not in issue. The Commission adopted the variable unit cost method as the better method, *id.* at 74, noting that this method was "more accurate" and that, in the abandonment proceeding before it, in contrast to previous decisions in which the Commission had rejected the method, "opposing parties have had adequate notice of applicant's intention to rely upon that technique and access to and opportunity to cross-examine upon both the utilized formula and the underlying working papers." *Id.* In these earlier cases, particular system operating ratios or variable unit costing methods were rejected because the Commission had not approved the particular method for use in abandonment proceedings, and the protestants to the abandonment application had not been afforded a sufficient opportunity to examine each step in the applicant's computations. *East Carolina Ry. Abandonment*, 324 I.C.C. 506, 512-513 (1964); *Chicago & N.W. Ry. Co. Abandonment*, 282 I.C.C. 525, 529-532 (1952); *Chicago*

[30] In that decision, the Commission rejected the railroad's estimate of its off-branch costs based on its system operating ratio because the railroad's own study of its out-of-pocket cost for beyond-line service indicated that 50 percent of the revenues was a reasonable estimate of that cost.

& N.W. Ry. Co. Abandonment, supra, 275 I.C.C. at 744-776.

The regulations before us adopt the variable unit cost method for use in the subsidy phase of the abandonment proceeding.[31] Moreover, as in *Baltimore & Ohio R.R. Abandonment—Landenburg Branch, supra*, 354 I.C.C. at 74, any opposing party does have "adequate notice of [an] applicant's intention to rely upon that technique and access to and opportunity to cross-examine upon, both the utilized formula and the underlying papers." See § 1121.42m. Therefore, the Commission's adoption of the variable unit cost method is not a departure from a prior norm. The Commission's previous position was simply that the 50 percent rule was the standard to be used in determining off-branch costs until a better method was shown to be available and fair to the parties.

Pennsylvania does not point to any basis in the language of the statute or the legislative history for its contention that Congress intended to preserve the 50 percent rule, much less to make its use mandatory in all cases. Given that the purpose of revising abandonment procedures was to facilitate relieving the railroads of the burden of continuing uneconomic branch lines and service, it is highly unlikely that Congress would have intended to prohibit the Commission from changing from an arbitrary formula for determining off-branch costs to one more likely to measure those costs realistically.

Even assuming, as Pennsylvania would have us do, citing *Greyhound Corp. v. I.C.C.*, 551 F.2d 414, 416 (D.C. Cir. 1977), that, in abandoning the 50 percent rule, the Commission "has made a substantial departure from prior norms, without adequate explanation," the Commission's regulations are not invalid. As we have ob-

[31] The regulations direct that an applicant use the same method in determining off-branch costs in its abandonment application as is utilized in determining the sufficiency of a subsidy offer, § 1132(d)(1), referring to § 1121.42(m)(1), which states that off-branch costs "shall be computed by applying variable unit costs." As both stages in the abandonment procedure involve ascertaining the costs incurred by continued branch line use, it is proper that the same method to compute off-branch costs be utilized.

served, the so-called rule is only a formula to be used when a better one is not available. It is a proceducal rule analogous to the one involved in *Pennsylvania v. United States*, 361 F.Supp. 208, 214-215 (M.D. Pa. 1973), *affirmed per curiam*, 414 U.S. 1017 (1973), where a similar argument was rejected.

Moreover, the Commission has provided a sufficient explanation for its abandonment of the formula. In its Report accompanying the regulations it stated that the Pennsylvania proposal for using a variant of the formula "would produce arbitrary and inaccurate results," and was lacking in "conceptual foundation." The Commission had already rejected the 50 percent rule as unreliable and imprecise in adopting its regulations implementing the subsidy provisions of the 1973 Act.[32] It did so apparently without objection from Pennsylvania, and the resulting redefinition of avoidable cost was approved in *Pennsylvania v. I.C.C.*, 535 F.2d 91, 96 (D.C. Cir. 1976), *cert. denied*, 429 U.S. 834 (1976). As the Commission said in its Report on Reconsideration of the regulations now before us, the costing standards for subsidy purposes and abandonment or discontinuance purposes should be the same.[33] It had said so in its notice of proposed rulemaking. 41 Fed. Reg. 31878, 31880-31881 (1976).

The Commission did not act inconsistently with § 1a or otherwise improperly in abandoning the 50 percent rule and framing the requirements for submission of data accordingly. Pennsylvania's challenge to the regulations is therefore without merit.

[32] See 49 C.F.R. § 1125.5(k)(1), which states that off-branch avoidable costs "shall be computed by applying variable unit costs to the service units attributed to the branch traffic during the subsidy period." The identical provision was incorporated by the Commission in its subsidy regulations under the 4-R Act. See note 31, *supra*.

[33] The Commission stated,

> Logic and sound administration dictate that they should be identical. If it were otherwise, the Commission, the railroad, and the public would be faced with the situation in which a possible offeror of financial assistance would not have the information necessary to formulate such an offer upon the filing of an abandonment application.

In No. 76-2283, the challenged regulations are remanded to the Commission for further proceedings consistent with this opinion. In Nos. 77-1008 and 77-1487 the petitions for review are denied.

SPRECHER, *Circuit Judge*, concurring in part and dissenting in part:

I concur with all portions of the majority opinion except IB.1. concerning the definition of "current cost."

It is clear that a railroad is entitled to be subsidized for the avoidable cost it incurs in operating a branch line, which cost is to include the depreciation which occurs to cars and other equipment used on the branch line. The Commission and the railroads disagree concerning what basis should be used to calculate this depreciation, the Commission arguing that the original cost of the branch line equipment is the proper standard, while the railroads contend that the value of new equipment (replacement cost) should provide the standard. I, contrary to the majority, think that the position of the Commission is sound both legally and logically, and would thus deny that portion of the petition for review.

Legally, the Commission's position is that it is merely continuing to employ the depreciation standard (original cost) which it has previously used under the Regional Rail Reorganization Act of 1973. There is no legislative history which would support the view that Congress meant to repudiate the Commission's regulation to that effect. Indeed, the only legislative support cited by the majority for its position is the testimony and proposal of one of numerous witnesses before the Senate Subcommittee on Commerce. Without any explicit direction from Congress and without any indication in the legislative history of Congress's dissatisfaction with the original cost standard being used by the Commission, I would conclude that the Commission acted reasonably by interpreting "current cost" to mean the current value of equipment being used on the branch line.

Beyond the dispute regarding legislative history, the Commission's position is even more compelling on the

basis of logic and economic analysis. We must ask ourselves what is the nature of the present economic saving that would result from discontinuance or abandonment. The majority assumes that the answer is that new equipment would not have to be purchased and thus the cost of this new equipment should set the standard for current costs. While initially appealing, this solution I believe miscomprehends the economic significance of abandonment to a railroad.

In basic terms, the present saving that results from discontinuance of a branch line is that the equipment from the branch line can be used on the main line. The use of this equipment does not *replace* the purchase of new cars as the railroads contend and as the majority agrees, but rather merely *postpones* the purchase of new cars for a period of time determined by the remaining useful life of the transferred equipment. This remaining value of the transferred equipment is approximated by depreciating the original cost of that equipment, as the Commission has mandated in its regulations.

The majority would award the railroad the cost of new cars and new equipment no matter what the true condition or usefulness to the railroad of the branch line equipment. I would agree with the Commission's more flexible position that the saving to the railroad is, in reality, merely the remaining value of the transferred cars. In the majority's example, this value would be the original cost of the equipment as depreciated after 29-years, or $3,000. This "use value" of the transferred cars is clearly the only "avoidable cost" the railroads can properly claim. Anything more overvalues the transferred equipment and provides more than mere compensation.

Not only do the railroads get an economic windfall under the majority approach, but the result reached there also provides an economic incentive to the railroads to provide poor quality equipment on the branch line. The railroads can always properly claim depreciation for tax purposes at the full rate for any new equipment purchased, which, in the example, is $20,000, whether or not this car is used on the branch line or on the main line. However, since the majority's approach also places a replacement cost value on the 29-year old car being

used on the branch line, the railroads get a "subsidy bonus" of the difference between the majority's mandated replacement cost depreciation standard and the true depreciation applicable to the branch equipment, which equals $20,000 minus $3,000 or $17,000. Thus, the raiproad receives an effective depreciation value of $37,-000 under these standards.

This "subsidy bonus" of $17,000 results purely from the use of a replacement cost standard to value branch line equipment, and increases in direct proportion to the decrease in the quality of equipment provided on the branch line. The Commission, on the other hand, would give the railroads a subsidy that reflects the quality of the equipment which is provided, which is $3,000 in the example.

If a railroad puts a new car on the branch, then the full depreciation value of that car should be subsidized. If, however, a railroad provides old cars on the branch line, then the subsidy should reflect the true value of those cars, as the Commission's regulations provide. The majority approach results in the anomaly of effectively saying to the railroads, "we will give you a replacement cost depreciation subsidy no matter how poor the condition of the equipment that you provide for the branch line. Indeed, you have the most to gain by using the worst equipment on the branch line."

The incentive to provide poor branch line equipment which flows from the majority's conclusion that "current cost" means "replacement cost" is clearly detrimental to continued and improved safety in the provision of rail service on branch lines, which result I would hesitate to reach in light of Congress's silence on this question. Therefore, the petition for review of the regulation concerning "current cost" should be denied.

Nos. 76-2283, 77-1008 & 77-1487

APPENDIX

. .

SECTION 1a. (1) No carrier by railroad subject to this chapter shall abandon all or any portion of any of its
. . lines of railroad (hereafter in this section referred to as "abandonment") and no such carrier shall discontinue the operation of all rail service over all or any portion of any such line (hereafter referred to as "discontinuance"), unless such abandonment or discontinuance is described in and covered by a certificate which is issued by the Commission and which declares that the present or future public convenience and necessity require or permit such abandonment or discontinuance. An application for such a certificate shall be submitted to the Commission, together with a notice of intent to abandon or discontinue, not less than 60 days prior to the proposed effective date of such abandonment or discontinuance, and shall be in accordance with such rules and regulations as to form, manner, content, and documentation as the Commission may from time to time prescribe. Abandonments and discontinuances shall be governed by the provisions of this section or by the provisions of any other applicable Federal statute, notwithstanding any inconsistent or contrary provision in any State law or constitution, or any decision, order, or procedure of any State administrative or judicial body. The authority granted to the Commission under this section shall not apply to (a) abandonment or discontinuance with respect to spur, industrial, team, switching, or side tracks if such tracks are located entirely within one State, or (b) any street, suburban, or interurban electric railway which is not operated as part of a general system of rail transportation.

(2)(a) Whenever a carrier submits to the Commission
. . a notice of intent to abandon or discontinue, pursuant to paragraph (1) of this section, such carrier shall attach thereto an affidavit certifying that a copy of such notice
. . (i) has been sent by certified mail to the chief executive officer of each State that would be directly affected by such abandonment or discontinuance, (ii) has been posted in each terminal and station on any line of railroad

proposed to be so abandoned or discontinued, (iii) has been published for 3 consecutive weeks in a newspaper of general circulation in each county in which all or any part of such line of railroad is located, and (iv) has been mailed, to the extent practicable, to all shippers who have made significant use (as determined by the Commission in its discretion) of such line of railroad during the 12 months preceding such submission.

(b) The notice required under subdivision (a) shall include (i) an accurate and understandable summary of the carrier's application for a certificate of abandonment or discontinuance, together with the reasons therefor, and (ii) a statement indicating that each interested person is entitled to recommend to the Commission that it approve, disapprove, or take any other specified action with respect to such application.

(3) During the 60-day period between the submission of a completed application for a certificate of abandonment or discontinuance pursuant to paragraph (1) of this section and the proposed effective date of an abandonment or discontinuance, the Commission shall, upon petition, or may, upon its own initiative, cause an investigation to be conducted to assist it in determining what disposition to make of such application. An order to the Commission to implement the preceding sentence must be issued and served upon any affected carrier not less than 5 days prior to the end of such 60-day period. If no such investigation is ordered, the Commission shall issue such a certificate, in accordance with this section, at the end of such 60-day period. If such an investigation is ordered, the Commission shall order a postponement, in whole or in part, in the proposed effective date of the abandonment or discontinuance. Such postponement shall be for such reasonable period of time as is necessary to complete such investigation. Such an investigation may include, but need not be limited to, public hearings at any location reasonably adjacent to the line of railroad involved in the abandonment or discontinuance application, pursuant to rules and regulations of the Commission. Such a hearing may be held upon the request of any interested party or upon the

Commission's own initiative. The burden of proof as to public convenience and necessity shall be upon the applicant for a certificate of abandonment or discontinuance.

(4) The Commission shall, upon an order with respect to each application for a certificate of abandonment or discontinuance—

(a) issue such certificate in the form requested by the applicant if it finds that such abandonment or discontinuance is consistent with the public convenience and necessity. In determining whether the proposed abandonment is consistent with the public convenience and necessity, the Commission shall consider whether there will be a serious adverse impact on rural and community development by such abandonment or discontinuance;

(b) issue such certificate with modifications in such form and subject to such terms and conditions as are required, in the judgment of the Commission, by the public convenience and necessity; or

(c) refuse to issue such certificate.

Each such certificate which is issued by the Commission shall contain provisions for the protection of the interests of employees. Such provisions shall be at least as beneficial to such interests as provisions established pursuant to section 5(2)(f) of this Act and pursuant to section 565 of Title 45. If such certificate is issued without an investigation pursuant to paragraph (3) of this section, actual abandonment or discontinuance may take effect, in accordance with such certificate, 30 days after the date of issuance thereof. If such a certificate is issued after an investigation pursuant to such paragraph (3), actual abandonment or discontinuance may take effect, in accordance with such certificate, 120 days after the date of issuance thereof.

(5)(a) Each carrier by railroad subject to this part shall, within 180 days after the date of promulgation of regulations by the Commission pursuant to this section, prepare, submit to the Commission, and publish, a full

and complete diagram of the transportation system operated, directly or indirectly, by such carrier. Each such diagram which shall include a detailed description of each line of railroad which is "potentially subject to abandonment", as such term is defined by the Commission. Such term shall be defined by the Commission by rules and such rules may include standards which vary by region of the Nation and by railroad or group of railroads. Each such diagram shall also identify any line of railroad as to which such carrier plans to submit an application for a certificate of abandonment or discontinuance in accordance with this section. Each such carrier shall submit to the Commission and publish, in accordance with regulations of the Commission, such amendments to such diagram as are necessary to maintain the accuracy of such diagram.

(b) The Commission shall not issue a certificate of abandonment or discontinuance with respect to a line of railroad if such abandonment or discontinuance is opposed by—

(i) a shipper or any other person who has made significant use (as determined by the Commission in its discretion) of such line of railroad during the 12-month period preceding the submission of an applicable application under paragraph (1) of this section; or

(ii) a State, or any political subdivision of a State, if such line of railroad is located, in whole or in part, within such State or political subdivision;

unless such line or railroad has been identified and described in a diagram or in an amended diagram which was submitted to the Commission under subdivision (a) at least 4 months prior to the date of submission of an application for such certificate.

(6)(a) Whenever the Commission makes a finding, in accordance with this section, that the public convenience and necessity permit the abandonment or discontinuance of a line or railroad, it shall cause such finding to be published in the Federal Register. If, within 30 days of such publication, the Commission further finds that—

(i) a financially responsible person (including a government entity) has offered financial assistance (in the form of a rail service continuation payment) to enable the rail service involved to be continued; and

(ii) it is likely that such proffered assistance would—

(A) cover the difference between the revenues which are attributable to such line of railroad and the avoidable cost of providing rail freight service on such line, together with a reasonable return on the value of such line; or

(B) cover the acquisition cost of all or any portion of such line of railroad;

the Commission shall postpone the issuance of a certificate of abandonment or discontinuance for such reasonable time, not to exceed 6 months, as is necessary to enable such person or entity to enter into a binding agreement, with the carrier seeking such abandonment or discontinuance, to provide such assistance or to purchase such line and to provide for the continued operation of rail services over such line. Upon notification to the Commission of the execution of such an assistance or acquisition and operating agreement, the Commission shall postpone the issuance of such a certificate for such period of time as such an agreement (including any extensions or modifications) is in effect.

(b) A carrier by railroad subject to this chapter shall promptly make available, to any party considering offering financial assistance in accordance with subdivision (a), its most recent reports on the physical condition of any line of railroad with respect to which it seeks a certificate of abandonment or discontinuance, together with such traffic, revenue, and other data as is necessary to determine the amount of assistance that would be required to continue rail service.

(7) Whenever the Commission finds, under paragraph (6)(a) of this section, that an offer of financial assistance has been made, the Commission shall deter-

mine the extent to which the avoidable cost of providing rail service plus a reasonable return on the value of rail properties involved exceed the revenues attributable to the line of railroad or the rail service involved.

(8) Petitions for abandonment or discontinuance which were filed and pending before the Commission as of February 5, 1976, or prior to the promulgation by the Commission of regulations required under this section shall be governed by the provisions of section 1 of this title which were in effect on February 5, 1976, except that paragraphs (6) and (7) of this section shall be applicable to such petitions.

(9) Any abandonment or discontinuance which is contrary to any provision of this section, of any regulation promulgated under this section, or of any terms and conditions of an applicable certificate, may be enjoined by an appropriate district court of the United States in a civil action commenced and maintained by the United States, the Commission, or the attorney general or the transportation regulatory body of an affected State or area. Such a court may impose a civil penalty of not to exceed $5,000 on each person who knowingly authorizes, consents to, or permits any violation of this section or of any regulation under this section.

(10) In any instance in which the Commission finds that the present or future public convenience and necessity permit abandonment or discontinuance, the Commission shall make a further finding whether such properties are suitable for use for other public purposes, including roads or highways, other forms of mass transportation, conservation, energy production or transmission, or recreation. If the Commission finds that the properties proposed to be abandoned are suitable for other public purposes, it shall order that such rail properties not be sold, leased, exchanged, or otherwise disposed of except in accordance with such reasonable terms and conditions as are prescribed by the Commission, including, but not limited to, a prohibition on any

such disposal, for a period not to exceed 180 days after the effective date of the order permitting abandonment unless such properties have first been offered, upon reasonable terms, for acquisition for public purposes.

(11) As used in this section:

(a) The term "avoidable cost" means all expenses which would be incurred by a carrier in providing a service which would not be incurred, in the case of discontinuance, if such service were discontinued or, in the case of abandonment, if the line over which such service was provided were abandoned. Such expenses shall include but are not limited to all cash inflows which are foregone and all cash outflows which are incurred by such carrier as a result of not discontinuing or not abandoning such service. Such foregone cash inflows and incurred outflows shall include (i) working capital and required capital expenditures, (ii) expenditures to eliminate deferred maintenance, (iii) the current cost of freight cars, locomotives and other equipment, and (iv) the foregone tax benefits from not retiring properties from rail service and other effects of applicable Federal and State income taxes.

(b) The term "reasonable return" shall, in the case of a railroad not in reorganization, be the cost of capital to such railroad (as determined by the Commission), and, in the case of a railroad in reorganization, shall be the mean cost of capital of railroads not in reorganization, as determined by the Commission.

A true Copy:

Teste:

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APPENDIX B

United States Court of Appeals

For the Seventh Circuit
Chicago, Illinois 60604

May 30, 19 78

Before

Hon. THOMAS E. FAIRCHILD, Chief Judge
Hon. ROBERT A. SPRECHER, Circuit Judge
Hon. PHILIP W. TONE, Circuit Judge

CHICAGO & NORTH WESTERN TRANSPORTATION COMPANY, et al.,
Petitioners,

Nos. 76-2283, 77-1008, and 77-1487 vs.

UNITED STATES OF AMERICA and INTERSTATE COMMERCE COMMISSION,
Respondents.

COMMONWEALTH OF PENNSYLVANIA,
Intervenors.

Petitions for Review of Orders and Regulations of the Interstate Commerce Commission.

These causes came on to be heard on the transcript of the record from the Interstate Commerce Commission, and were argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that in Appeal No. 76-2283, the challenged regulations are REMANDED to the Commission for further proceedings consistent with the opinion of this court, and the petition for Review of Orders and Regulations in Appeals Nos. 77-1008 and 77-1487 are hereby, DENIED, in accordance with the opinion of this Court filed this date.

APPENDIX C

United States Court of Appeals

For the Seventh Circuit
Chicago, Illinois 60604

July 31, 19 78

Before

Hon. THOMAS E. FAIRCHILD, Chief Judge
Hon. PHILIP W. TONE, Circuit Judge*/
Hon.

CHICAGO AND NORTH WESTERN TRANSPORTATION COMPANY, et al.,
Petitioners,

No. 76-2283 vs.

UNITED STATES OF AMERICA and INTERSTATE COMMERCE COMMISSION,
Respondents.
COMMONWEALTH OF PENNSYLVANIA,
Intervenor.

On Petition for Review of Orders and Regulations of the Interstate Commerce Commission

ORDER ON PETITION FOR REHEARING

The opinion in this cause issued May 30, 1978, is modified by deleting present Part B,2, on pages 18 and 19, and substituting the following:

2. "Expenditures to Eliminate Deferred Maintenance"

The railroads also challenge the Commission's interpretation of the words, "expenditures to eliminate deferred maintenance," which also appear in the statutory definition of avoidable cost. Again, notwithstanding the new statutory language, the Commission followed its regulations under the 1973 Act, this time merely adopting verbatim the language

*/ Circuit Judge Robert A. Sprecher participated in the original decision but has disqualified himself from consideration of the petition for rehearing.

of those regulations. Section 1121.42(b) of the new regulations provides that rehabilitation costs are not to be included unless

> (A) the track involved does not meet minimum Federal Railroad Administration (FRA) Class I safety standards (49 CFR 213) ...; or (B) the potential subsidizer requests a level or service which requires expenditures for rehabilitation.

With respect to (A), FRA Class I safety standards are satisfied if the track is safe for operating speeds of 10 miles per hour or lower. 49 C.F.R. § 213.9. The railroads argue that frequently the level of efficient railroad operation far exceeds 10 miles an hour, and in such cases it would be economical to rehabilitate the line above Class I safety standards to produce savings in the costs of labor, fuel, rental of equipment, etc.; yet the regulation does not permit recovery of "expenditures for deferred maintenance" necessary to rehabilitate the line above the 10-miles-per-hour level.

Initially we sustained the railroads' challenge to § 1121.42(b). Upon reconsidering the point as a result of the Commission's petition for rehearing, however, we have reached a contrary conclusion. Congress' requirement is that the railroad recover from the subsidizer "expenditures to eliminate deferred maintenance." If the potential subsidizer requests a level of service that requires expenditures for rehabilitation in excess of those necessary to bring the track involved up to Class I safety standards, those expenditures are included in avoidable costs under Clause (B) of § 1121.42(b). If such a request is not made, the railroad will only need to make those expenditures for deferred maintenance that are necessary to bring the track up to Class I safety standards, see Clause (A). In the latter event, there will be no expenditures for deferred maintenance that the railroad does not recover from the subsidy. If, as a result of having to operate trains at speeds no greater than 10 miles per hour the railroad will incur additional costs, they can be recovered as other elements of avoidable costs. Accordingly, the railroad will be made whole even if it is required to operate the line in question inefficiently.

It may well be, as the railroads argue, that the Commission was unwise not to leave itself free to tie the subsidization of deferred maintenance to the most efficient level of operation. Perhaps the public interest would have been better served if avoiding

> inefficiency in operation had been accorded a higher place on the Commission's scale of values than continuation of service. These are matters for the Commission's judgment, however. A court may not set aside the Commission's action so long as the regulations permit the railroad to recover expenditures actually made for deferred maintenance and other avoidable costs, as the statute requires.
>
> If the regulations did not provide that avoidable costs are to include all expenditures actually made for deferred maintenance and all expenditures required because of inefficiency of operations at a 10-miles-per-hour level, they would be inconsistent with the statute. As we read them, however, they do require that the subsidy make the railroad whole for its avoidable costs in these categories, and § 1121.42(b) is therefore valid.

Except for the foregoing modification of the opinion, the petition of the respondent Interstate Commerce Commission for rehearing is DENIED.

United States Court of Appeals

For the Seventh Circuit
Chicago, Illinois 60604

August 11, 1978

Before

Hon. THOMAS E. FAIRCHILD, Chief Judge

Hon. PHILIP W. TONE, Circuit Judge *

Hon. _____

CHICAGO AND NORTH WESTERN TRANSPORTATION COMPANY, et al., Petitioners,

No. 76-2283 vs.

UNITED STATES OF AMERICA and INTERSTATE COMMERCE COMMISSION, Respondents.

COMMONWEALTH OF PENNSYLVANIA, Intervenor.

On Petition for Review of Orders and Regulations of the Interstate Commerce Commission

ORDER STAYING OF MANDATE ON CONDITION

The Interstate Commerce Commission has moved to stay the mandate of this court for 90 days "to enable the Commission to determine whether a writ of certiorari should be applied for, and to accomplish the filing of its application therefor, or to attempt to bring its subject regulations into conformity with" this court's decision.

* Circuit Judge Robert A. Sprecher participated in the original decision but did not take any part in the consideration of the motion for stay of mandate.

So far as our decision would affect the validity of the regulations, a stay is appropriate during the pendency of any certiorari proceedings.

Insofar as our decision requires the Commission to reexamine matters dealt with in the regulations held invalid with a view to promulgating revised regulations consistent with our decision, we are reluctant to give our approval to delaying that task and see no reason that it should not go forward even if a petition for certiorari is filed.

Accordingly, the issuance of the mandate is stayed for 30 days on condition that the Commission proceed with the reconsideration of regulations required by our decision with a view to the ultimate issuance of new regulations in conformity with that decision.

F-9755

INTERSTATE COMMERCE COMMISSION

EX PARTE NO. 274 (SUB-NO. 2)

ABANDONMENT OF RAILROAD LINES AND DISCONTINUANCE OF SERVICE

Decided November 5, 1976

Regulations to implement section 1a of the Interstate Commerce Act, relating to the abandonment of rail lines and the discontinuance of rail service, adopted.

Constance L. Abrams, Donald T. Bliss, and *William A. Kutzke* for the United States Department of Transportation.

Winifred Sheridan Smallwood for the Florida Department of Transportation.

Robert S. Steiner for the Transportation Regulation Board of the Iowa Department of Transportation.

David A. Wagner for the Maryland Department of Transportation.

John G. Brawley for the Missouri Department of Transportation.

Raymond T. Schuler for the New York Department of Transportation.

Robert P. Kane and *Gordon P. MacDougall* for the Commonwealth of Pennsylvania.

Louis J. Carter and *Charles J. Sludden* for the Pennsylvania Public Utilities Commission.

Joe Norton and *John D. Therrien* for the South Dakota Department of Transportation and Public Utilities Commission.

Harry J. Breithaupt, Jr., James I. Collier, Jr., Neill W. McArthur, Jr., Michael E. Roper, Daniel J. Sweeney, and *William A. Thie* for individual railroads and a railroad association.

Louis J. Carter, William G. Mahoney, and *Charles J. Sludden* for railroad labor organizations.

Barbara M. Adams, William R. Allen, Jr., C. W. Bath, Don A. Boyd, John M. Cleary, John F. Donelan, J. Donald Durand, Donald A. Frederick, Robert L. Graves, Donald E. Graham, Vernon J. Haan, James S. Krzyminski, Bayard Marin, John K. Maser III, Thomas E. MacFarland, Jr., George J. McCusker, William R. Rubbert, Harold E. Spencer, Henrik Stafseth, and *Frederick L. Wood* for shippers and other interested parties.

REPORT OF THE COMMISSION

BY THE COMMISSION

This proceeding was instituted on July 30, 1976, by the service and publication in the Federal Register (41 F.R. 31878) of a notice of proposed rulemaking and accompanying draft regulations governing the filing and processing of applications to abandon or discontinue rail services. The public was given the opportunity to participate through the submission of written initial and reply statements.[1]

BACKGROUND

In our notice, we announced that we had under consideration significant revisions to part 1121 of Title 49 of the Code of Federal Regulations which contains our regulations relating to the abandonment and discontinuance of rail service. Changes in these regulations were made necessary by the enactment, on February 5, 1976, of Public Law 94-210, the Railroad Revitalization and Regulatory Reform Act of 1976 (the 4R Act).

The new legislation made major revisions in the provisions of the Interstate Commerce Act (the act) affecting the abandonment of rail lines and the discontinuance of rail service. Prior to the enactment of these amendments, the statutory provisions governing the construction or extension of rail lines and those governing the abandonment or discontinuance of rail service were intermingled in paragraphs 1(18) through (22) of the act. Section 801 of the 4R Act reenacted those provisions of the act governing the construction and extension of rail service and consolidated them in an amended paragraph 1(18). Paragraphs 1(19) through (22) were repealed, and sections 802 and 809 of the 4R Act consolidated the provisions

[1] The participating parties were: the United States Department of Transportation, the Florida Department of Transportation, the Transportation Regulation Board of the Iowa Department of Transportation, the Maryland Department of Transportation, the Missouri Department of Transportation, the New York Department of Transportation, the Commonwealth of Pennsylvania, the South Dakota Department of Transportation, the Pennsylvania Public Utilities Commission and the Pennsylvania State Legislative Board of the United Transportation Union (jointly), the Railway Labor Executives' Association and the Brotherhood of Railway and Airline Clerks (jointly), the Association of American Railroads, the Green Bay and Western Railroad Company, the Missouri-Kansas-Texas Railroad Company, the Seaboard Coastline Railroad Company, the Association of Oil Pipelines, Coopers & Lybrand, E. I. DuPont de Nemours and Company, Farmland Industries, Inc., FS Services, Inc., and International Minerals and Chemical Corporation (jointly), Land O'Lakes Agricultural Services, the National Council of Farmer Cooperatives, the National Industrial Traffic League, the Railroad Task Force for the Northeast Region, Inc., Union Equity Co-Operative Exchange, and the Western Region of the National Conference of State Railway Officials.

relating to the discontinuance and abandonment of rail service in a new section 1a of the act.[2]

The 4R Act changes the abandonment and discontinuance provisions in three principal respects. First, section 303, which amends section 17 of the act, requires that abandonment applications be processed to conclusion by the Commission within certain rigid time limits. Second, it greatly expands and changes the type of public notice which is required to be given by a railroad proposing to abandon a line or discontinue service. Third, it provides an opportunity for persons wishing to preserve a line, with respect to which the Commission has found that the public convenience and necessity permit abandonment or discontinuance, to offer financial assistance to the railroad, and it provides that the Commission must defer the issuance of a certificate authorizing abandonment or discontinuance to permit negotiation of a financial assistance agreement.

The formulation and adoption of regulations to implement the new abandonment and discontinuance provisions has been complicated by the statutory division between the Commission and its Rail Services Planning Office (RSPO) of the authority to establish certain standards to be used in evaluating abandonment and discontinuance applications and in computing financial assistance. RSPO is given the statutory responsibility, in section 309 of the 4R Act, for defining "avoidable costs of providing rail service" over a line of railroad which is subject to abandonment. RSPO is not, however, given the specific responsibility for establishing standards for determining revenues attributable to the line, as that term is used in section 1a of the act, and the Commission is required to determine reasonable return on the value of rail properties. The Commission and RSPO, therefore, instituted this proceeding on a joint basis so that all three of these terms could be concurrently defined. Thus, a single set of standards will be available for use by the Commission and the public to determine the costs and revenues of the line to be abandoned or the service to be discontinued and the amount of financial assistance which would have to be offered to assure continuation of rail services which might otherwise be abandoned or discontinued.

The draft regulations which accompanied our notice of proposed rulemaking were voluminous, and they are not being reproduced in full as part of this report. Pertinent portions of the proposed

[2]Further amendments of new section 1a, effected by section 218 of Public Law 94-555, the Rail Transportation Improvement Act, enacted October 19, 1976, will be discussed below.

regulations are set out in the text of the report, however, where this is necessary to understand our discussion of the positions of the parties and any changes which we have deemed necessary.

General

The proposed regulations were divided into four subparts. Subpart A contained a general statement of purpose and a number of definitions. Subpart B dealt with the requirement of section 1a(5) of the act that each railroad publish a diagram of its system showing lines "potentially subject to abandonment." Subpart C contained procedures to be followed in the filing of abandonment applications, in making offers of financial assistance looking toward the continuation of service over lines that would otherwise be abandoned, and the conversion of abandoned rail properties to other public uses. Subpart D contained standards for determining the revenues attributable to, the avoidable costs of providing service over, and the reasonable return on the value of rail lines subject to abandonment proposals. The regulations being adopted follow the same basic format as those proposed.

The regulations promulgated in this proceeding are basically procedural in nature. They are designed to implement the abandonment and discontinuance procedures mandated by the Congress, but they cannot anticipate and resolve the myriad substantive issues that arise in individual abandonment cases. Questions of *de facto* abandonment, deliberate downgrading of service, and unlawful embargoes can only be dealt with in the context of abandonment applications as they come before the Commission. To the extent that the comments of the parties address issues such as these, they will not be further considered.

In addition to seeking comment on the proposed regulations themselves, the Commission invited interested parties to express their views on three matters not specifically covered in the proposed rules.

The 34-carload rule.—The Commission's present regulations governing abandonment applications, 49 CFR §1121.23, provide for a rebuttable presumption to the effect that if fewer than 34 carloads of freight per mile were carried over a line for which abandonment authority is sought during the 12-month period preceding the filing of the abandonment application, abandonment of the line would be consistent with the public convenience and necessity.

In the notice of proposed rulemaking in this proceeding, we noted that we did not intend to incorporate the 34-carload rule into the new regulations, but that we were considering retaining it as one "evidentiary benchmark" in our evaluation of abandonment and discontinuance applications. Public comment was requested on the continued use of the 34-carload rule.

The parties commenting on this issue overwhelmingly favor the complete repudiation of the 34-carload rule. Many of them argue that the Congress, in requiring the Commission to define precisely the costs and revenues attributable to rail lines which are the subject of abandonment applications, and by requiring RSPO to establish branch-line accounting standards, in effect directed that the 34-carload presumption be abandoned. Upon further reflection, we believe that, in view of the cost and revenue standards being adopted here, there is no longer any necessity to rely on the 34-carload rule. It will not, therefore, be retained for any purpose.

The spur-track exemption.—Former section 1(22) of the act contained an exemption from our abandonment jurisdiction for spur, industrial, team, switching, and side tracks. This exemption was omitted from section 1a as enacted by the 4R Act, and we had reason to believe that this omission was inadvertent. We sought public comment on this matter.

This question has been resolved by the enactment, on October 19, 1976, of Public Law 94-555, the Rail Transportation Improvement Act. Section 218(a) of that statute amends section 1a(1) of the act by adding the following new sentence: "The authority granted to the Commission under this section shall not apply to (a) abandonment or discontinuance with respect to spur, industrial, team, switching, or side tracks if such tracks are located entirely within one State, or (b) any street, suburban, or interurban electric railway which is not operated as part of a general system of rail transportation."

Labor protective conditions.—Section 1a(4) of the act requires that the Commission, in authorizing an abandonment, provide for the protection of the interests of railroad employees, and that the protective provisions be at least as beneficial as those established pursuant to section 405 of the Rail Passenger Service Act (45 U.S.C. §565). Assuming that this new requirement might mean some modification in the type of labor-protective conditions now imposed in certificates of abandonment, we suggested in our notice of proposed rulemaking that it might be appropriate to develop such protective conditions in this proceeding rather than later on a case-by-case basis.

The principal spokesmen for railway labor participating in this proceeding—the Railway Labor Executives' Association (RLEA) and the Brotherhood of Railway and Airline Clerks (BRAC) do not favor this approach, and the divergent views of the other parties to this proceeding have convinced us that it would not be possible to develop appropriate employee protective conditions on this record. They will be imposed, with the benefit of a more complete record, on a case-by-case basis as we consider individual abandonment proceedings arising in the future.

THE REGULATIONS

Our discussion of the regulations as proposed and as adopted, and of the public comments respecting them, will be limited to those provisions of the regulations which have either been challenged by one of the parties or which have been determined, on our own initiative, to require some modification or clarification. The regulations adopted reflect a number of modifications of an editorial or noncontroversial nature which are not specifically discussed in this report.

SUBPART A—GENERAL

Section 1121.11(c).—As proposed, this paragraph read as follows:

(c) "Base year" means the calendar year immediately preceding the year in which the abandonment or discontinuance application is filed with the Commission or any later 12-month period for which data has been collected at the branch level as prescribed in section 1121.40(b).

The United States Department of Transportation (DOT) believes that a more appropriate reporting period would be the latest 12-month period which concludes no later than 3 months prior to the filing of the abandonment application. It contends that the carriers collect these data daily or monthly, and that allowing 3 months for their processing would not be burdensome. The Association of American Railroads (AAR) does not object to the substance of the DOT proposal, but believes that 3 months would be too short of a period to summarize relevant data, and urges a period ending no later than 6 months prior to the filing of the application.

We believe that the use of the calendar year immediately preceding the filing date could, in some instances, result in a record containing information that could be outdated when it was

filed, and favor the use of the latest 12-month period for which data has been collected. We further agree with AAR that a filing period ending no later than 3 months from filing might create hardships in submitting such data, and that the latest 12-month period should end no later than 6 months prior to filing of the abandonment or discontinuance application. Section 1121.11(c) will, therefore, be amended to read:

(c) "Base year" means the latest 12-month period, ending no later than six months prior to the filing of the abandonment or discontinuance application, for which data has been collected at the branch level as prescribed in section 1121.40(b).

Section 1121.11(m).—This paragraph contains the definition of the term "significant user" and implements one of the key concepts of the public notice provisions of the new abandonment procedures. Section 1a(2) of the act requires actual notice of an abandonment proposal to be served by the applicant upon those who have made "significant use" of the line in question. The term "significant user" was defined as follows in the proposed regulations:

(m) "Significant user" means any shipper which, during the 12-month period preceding the month the abandonment or discontinuance is filed, originated and/or received either (1) 10 percent or more of the carloads or (2) 50 or more carloads on the line proposed for abandonment or discontinuance.

As pointed out by many parties, including the New York Department of Transportation (New York), the National Industrial Traffic League (NITL), the Pennsylvania Public Utilities Commission and the Pennsylvania State Legislative Board of the United Transportation Union (Pennsylvania PUC and UTU), this definition of "significant user" could, in certain circumstances, result in some very substantial users of rail service not receiving direct advance notice of the filing of an abandonment application. For example, where a line generated 500 carloads in a 12-month period, and where there were 12 patrons on the line each generating 40 carloads, none of them would be a "significant user" entitled to notice of the application. We will amend this definition to read as follows:

(m) "Significant user" means (1) each of the 10 rail patrons which originated and/or received the largest number of carloads (or each patron if there are less than 10), and (2) any other rail patron which originated and/or received 50 or more carloads, on the line proposed for abandonment or discontinuance, during the 12-month period

preceding the month in which notice is given of the abandonment or discontinuance application.

SUBPART B—SYSTEM DIAGRAM

Section 1a(5) of the act requires each carrier to file with the Commission, and to publish, a full and complete diagram of its rail system, identifying each line which is "potentially subject to abandonment" as that term is defined by the Commission. The regulations proposed under subpart B to implement this requirement have given rise to substantial public comment in only two respects: the definition of lines which are "potentially subject to abandonment" contained in section 1121.20(b)(1) and (2); and the requirements governing the publication and amendment of the system diagram contained in sections 1121.22 and 1121.23.

Lines potentially subject to abandonment.—The text of section 1121.20(b)(1) and (2) of the proposed rules was as follows:

(b) All lines in each carrier's rail system shall be separated into the following categories:

(1) All lines or portions of lines which the carrier believes to be potentially subject to abandonment because the carrier anticipates an abandonment or discontinuance application will be filed within the 3-year period following the date upon which the diagram, or any amended diagram, is filed with the Commission;

(2) All lines or portions of lines which may become potentially subject to abandonment because, in the carrier's best judgment, the cost of performing rail service exceeded the revenues from performance of that service by 20 percent or more during each of the two most recent 12-month accounting periods preceding the date upon which the diagram, or any amended diagram, is filed with the Commission but for which the carrier does not anticipate an abandonment or discontinuance application will be filed; ***.

The remaining provisions of section 1121.20(b) describe three other categories of line that must be identified on the system diagram: lines for which an abandonment or discontinuance application is pending before the Commission, lines which are being operated under subsidy; and all other lines on the carrier's system.

The purpose of requiring a public notice of lines "potentially subject to abandonment" is, as we conceive it, two fold. First, it is to give notice to the users of the service provided over light-density branch lines, and the communities served by such lines, that they are likely to face an attempt by the carriers to abandon service. Second, it is to give the Commission, other Federal agencies, the States, local communities, rail service users, and the carriers

themselves an opportunity to plan intelligently and effectively to develop and maintain an integrated transportation system.

There is general agreement that the system diagram should identify lines which the carrier itself intends to abandon in the foreseeable future. In fact, section 1a(5)(a) of the act requires that the system diagram depict lines which the carrier "plans" to abandon. Category 1 will, therefore, be retained.

The basic question raised by the comments of the parties, and which we must resolve, is whether it is sufficient to leave it to the discretion of the carrier to list on its system diagram as lines potentially subject to abandonment those which it has already concluded can no longer be operated viably, and which it currently plans to abandon (category 1 lines); or whether we should impose, as proposed in establishing category 2, some other measure which will result in a line's being included in the diagram as potentially subject to abandonment. We have no doubt that some objective standard of line viability would be desirable, and it was with this in mind that we originally proposed the listing of lines in category 2. The problem, however, is that the adverse effects of identifying the category 2 lines, as defined in the proposed regulations, on the system diagram appear to outweigh the benefits.

AAR would delete category 2 altogether to avoid stigmatizing the lines so listed in the mind of the public, and thereby eliminating any possibility of industrial development or increased traffic. The Pennsylvania PUC and UTU argue that listing a line in category 2 would sound "the death knell of any branch so listed as no shipper will locate on the line and existing shippers will seek other modes of transportation." The Western Region of the National Conference of State Railway Officials (Western Region) criticizes category 2 because "uniform application of the criteria to determine whether a line should be placed in this category is impossible." The National Industrial Traffic League (NITL), however, supports the proposed dual categorizing of lines "as both useful and workable."

We have concluded that the definition of lines falling into category 2 must be substantially modified. We do not believe it approrpriate to publicize, as economic losers, lines which the carrier has no thought of abandoning, and we agree with those who fear that such a label may discourage future business for the line and become a self-fulfilling prophecy. However, we believe that we must include in the regulations a category of lines "potentially subject to abandonment" in addition to those which the carrier itself

has concluded should be made subject of an abandonment application.

Section 1a(5)(a) of the act requires the listing on the system diagram not only of lines which the carrier plans to abandon, but also of lines which are "potentially subject to abandonment" as defined by the Commission. Our reading of this language is that the establishment of two categories of lines potentially subject to abandonment has been mandated by the Congress. A second category of such lines will, therefore, be included, embracing lines which are being studied by the carrier as candidates for possible future abandonment because of excessive anticipated operating losses or rehabilitation costs.

The publication of the system diagram with these lines properly identified will alert the public not only to the carrier's present, but also to its long-range, plans. Thus appropriate contingency measures can be taken either to assure retention of the service or to make plans for handling the traffic involved by alternative means. The State, regional, or local planning bodies will be given a greater opportunity to study the impact of a potential abandonment on the economy of the area served by the line; to determine whether financial support should be offered in order to retain service; to determine whether any public use exists for the rail right-of-way involved; or to take other action to alleviate the problems which the users of the line would face if their service were terminated. At the same time, lines which the carrier has no intention of abandoning will not be listed and their future viability jeopardized.

In the regulations being adopted, category 2 (section 1121.20(b)(2)) will read as follows:

> (2) All lines or portions of lines potentially subject to abandonment which the carrier has under study and believes may be the subject of a future abandonment application because of either anticipated operating losses or excessive rehabilitation costs, as compared to potential revenues.

We are also amending section 1121.23 by adding a new paragraph (b) requiring that any system diagram which includes a line in category 2 must be revised annually to reflect clearly the carrier's decision whether to transfer the cateogry 2 line to category 1, whether to remove it altogether from the list of lines "potentially subject to abandonment," or whether to retain it in category 2 for further study.

The remaining categories will be adopted unchanged, and will include those lines for which an abandonment or discontinuance

application is pending (category 3); those lines which are being subsidized under section 1a(6)(a) of the act or section 304(c)(2) of the Regional Rail Reorganization Act of 1973 (category 4); and all other lines which are owned and operated by the carrier (category 5).

Publication and amendment of the system diagram.—The proposed regulations governing the initial filing and publication of the system diagram and accompanying line descriptions appeared in section 1121.22, and the regulations governing their amendment and updating were contained in section 1121.23. The color-coded map and line description were required, under section 1121.22(a) and (b), to be filed with the Commission and to be served upon the Governors and public service commissions, or equivalent agencies, in the States where the carrier conducts operations. These provisions are retained in the regulations adopted, except that service of a color-coded map and line description upon the designated State agency (see section 803 of the 4R Act) will also be required.

Considerable controversy has arisen over the publication and posting requirements of proposed section 1121.23(c), which read as follows:

(c) The carrier shall publish a black and white version of the system diagram map and the accompanying line descriptions in a newspaper or newspapers with statewide circulation in each State within which the carrier owns or operates a line of railroad and shall post a black and white or color-coded version of the system diagram map in each agency station and terminal located on a line of railroad owned or operated by the carrier.

It should be noted that these publishing and posting requirements would have applied both to the initial issuance of the system diagram and line description, and, under proposed section 1121.23(a) and (b)(1), to subsequent amendments and updates.

The railroad interests strongly object to the proposed publication and posting requirements as being excessively expensive and as serving no useful purpose. To some extent, we sympathize with their position. The clear language of the statute, however, requires the system diagram map to be published. To achieve technical compliance with that requirement, the Commission will arrange for publication in the Federal Register, but we do not believe that Federal Register publication alone would provide effective notice to the type of rail service user and local community served by light-density rail lines which are likely to be candidates for abandonment.

We will, therefore, require publication in a newspaper circulating in each county within which there is located a line listed in either category 1, 2, or 3. The newspaper notice will be required to include a copy of the system diagram map or, at the carrier's option, a portion of that map clearly depicting its lines in the county, as well as a description of each line in the county classified in category 1, 2, or 3.

We agree that the posting of a copy of the system diagram map in every station and terminal on the railroad would be unduly burdensome and would not really provide an effective means for public dissemination of information about lines potentially subject to abandonment. This requirement will be modified to require posting only in stations on or serving lines listed in categories 1, 2, and 3. The posting requirement may be fulfilled by simply posting a copy of the appropriate newspaper notice. The regulations will also provide that copies of the system diagram maps must be furnished, upon request, at reasonable cost.

As adopted, paragraph 1121.22(c) of the regulations will read as follows:

(c) The Commission shall publish a black and white version of the initial system diagram map as submitted in accordance with section 1121.20(d) and accompanying line description in the Federal Register. The carrier shall (i) publish in a newspaper of general circulation in each county within which is located a line in category 1 through 3 (section 1121.20(b)(1)-(3)) a notice containing a black and white copy of the system diagram map (or of a portion of the map clearly depicting its lines in such county) and a description of each such line; (ii) post a copy of the newspaper notice in each agency station or terminal on each line in category 1 through 3 (section 1121.20(b)(1)-(3)) or, if there is no agency station on the line, at any station through which business for the line is received or forwarded, and (iii) furnish, at reasonable cost, upon request of any interested person a copy of its color-coded or black and white system diagram map and the publication in the county newspaper shall so indicate.

Finally, we are adding to this section of the regulations a new paragraph (e) providing for republication of the required notice should we find it to be inadequate.

Availability of data.—The South Dakota Department of Transportation (South Dakota) has suggested that railroads be required to make known the net salvage value of any line placed in category 1 in the system diagram. We agree that such information would be of value to the designated State agencies in fulfilling their planning functions. We will include such a provision in the regulations as section 1121.24, and will renumber section 1121.24 of the proposed regulations. However, instead of using the term "net

salvage value," we will refer to "net liquidation value," which is defined in subpart D of these regulations. In addition to information as to net liquidation value, we think it appropriate to require the railroad, upon request, to provide a description of the lines in category 1 and of any appurtenant facilities, and of their condition. The new section will read as follows:

Section 1121.24—Availability of data

Each carrier shall provide to the designated state agency, upon request, information concerning the net liquidation value (as defined in section 1121.43(c) of this part) of any line placed in category 1 (section 1121.20(b)(1)) on its system diagram map or line description, together with a description of such a line and any appurtenant facilities and of their condition.

SUBPART C—PROCEDURES GOVERNING NOTICE, APPLICATIONS, FINANCIAL ASSISTANCE, AND ACQUISITION FOR PUBLIC USE

Notice.—Section 1121.30 of the proposed regulations provided for the posting of a notice of any proposed filing of an abandonment or discontinuance application; section 1121.31 specified the form of notice required.

These provisions required carriers, during the 30-day period prior to the filing of an abandonment or discontinuance application, to serve notice of their intent to abandon or discontinue service upon the Governors, public service commissions, and designated State agencies, of the affected States, and upon this Commission, and to post copies of the notice in stations on or serving the lines in question. Several parties have commented on the form of notice.

The Missouri-Kansas-Texas Railroad Company (M-K-T), expressed some confusion as to why we would require service on three State agencies when, in its opinion, service on only the Governor and the Public Service Commission should be sufficient. It recommends modifying the provision to require service on some other State agency only if such agency exists.

Under the act, States are required, *inter alia*, to designate an agency to administer their State rail plans before they can become eligible for national subsidy funds under the Local Rail Service Assistance provision of section 5 of the Department of Transportation Act, as amended by section 802 of the 4R Act. That agency might be the State's Department of Transportation, its Public Service Commission, or some other governmental unit. Whatever agency is so designated, we think it self-apparent why it should be served with the applicant's notice of intent. Furthermore, we view it

to be abundantly clear that if a State has not designated a State agency, then no such agency exists for purposes of service of the notice. Likewise, if the designated State agency is the Public Service Commission, service of a single notice will satisfy the service requirement of the regulations.

DOT considers the prescribed notice form inadequate because it fails to address the issue of what the reader is supposed to do in response. It suggests that the regulations be amended to delete the paragraph describing actions which can be taken pursuant to the notice.

As previously indicated, notice of intent must be published within 30 days of the actual filing of the application. This requirement serves to alert all interested persons of the imminent filing and allows for the prompt request for an application by a potential offeror of financial assistance or other interested person. We remain firm in our view that, at minimum, the notice should advise interested persons of their right to recommend approval, disapproval, or other action by the Commission and to become parties to the proceeding by filing a petition to investigate or written comments. However, in consideration of the confusion the proposed form has generated, and rather than exclude from the notice any advice as to what action may be taken, we have revised the form to expand upon what information will be required in a comment or petition. We will also require that the notice advise any interested person proposing to file a comment or petition that the applicant will furnish a copy of the application upon request. This will serve both to provide prospective parties with the best possible information about the application and to assure that the Commission will not receive comments based on inadequate information. Other modifications to the notice are being made to conform to certain changes in the requirements for participation in the proceeding discussed below.

The application.—Section 1121.32 of the proposed regulations detailed the required contents of an abandonment or discontinuance application. As pointed out in the notice of proposed rulemaking, the time limits established by the 4R Act amendment leave us no choice but to require that virtually the entire case-in-chief be submitted by each applicant with the initial filing of its application. In addition, certain data were required in order to enable persons interested in acquiring or subsidizing a line proposed for abandonment to make the necessary cost and revenue determinations. For the most part, the parties have recognized the constraints under which the Commission must operate in processing

applications and the overriding congressional intent both to expedite the handling of abandonment proceedings and to assure that all interested persons are provided with full and complete information about the carrier's proposal.

We will take up first objections which have been raised to the inclusion of certain information requirements in the application. The M-K-T and the Seaboard Coastline Railroad Company object, first, to the requirement of section 1121.32(c)(5) that overhead or bridge traffic handled on the line to be abandoned be identified by carload commodity group tonnage. Our present regulations governing the filing of abandonment applications require that this traffic be identified, and we have not found that this requirement has been unduly difficult for applicants to meet—perhaps because the majority of abandonment applications involve branch lines which carry little or no bridge traffic. Where the line does carry such traffic, that fact is obviously of importance in determining the place the line plays in the carrier's overall system. The regulations adopted will retain this requirement.

These same two carriers also claim that the inclusion of the requirement in section 1121.32(d)(3) that the application include a computation of the estimated subsidy payment would be unduly burdensome. We think it essential, if the Commission is to obtain accurate information concerning the profit or loss which resulted in operating the line, to require the carrier to provide us with a computation of the avoidable costs, revenues attributable, and reasonable return on the value of the line which is the subject of the application, as these terms are defined in subpart D of the regulations. Having made these computations, we fail to see why the further computation of an estimated subsidy payment should pose any problem whatsoever to the applicant.

Two other points raised by the parties are, we think, well taken. Section 1121.32(c)(3) will be modified to require the carrier to inform us of the *average* number of locomotive units operated on the line during the 2 years preceding the filing of the application. Also section 1121.32(c)(4) will be modified so that the applicant need not pinpoint its carload commodity group tonnage by station. As pointed out by DOT and M-K-T, to require identification by station would increase the likelihood that confidential shipper information would be disclosed.

Under section 1121.32(e)(5), the carrier would be required to state whether properties proposed to be abandoned are suitable for use for other public purposes. DOT expressed reservations on the

efficacy of this requirement, citing the railroads lack of expertise in the matter. We agree that many States may be better equipped to deal with the problem; however, requiring the railroad to present us with its view will assure that the issue is clearly presented; and indeed, we think that in many instances the railroad will prove to be well informed on this matter. We are aware of a number of cases in which the carrier worked closely with the local community in an effort to gain its support for a particular abandonment proposal, and was thus well aware of possible community uses for its property. We would, of course, hope and expect that the affected State and local agencies would also submit their views.

South Dakota has questioned whether section 1121.32(f) constitutes an attempt to transfer the Commission's responsibilities under the National Environmental Policy Act of 1969 to the railroads. It further states that serious questions could be raised as to the propriety of having the proponent of the action prepare the environmental data.

The Commission is required to make a finding, based upon its own analysis, of the effect of an abandonment upon the environment. To do this expeditiously, we require the submission of environmental information by the applicant at the inception of the process. The data submitted is then examined independently and impartially. Also, since the applicant has standing to make known its views about the environmental impact of its proposal, this factor becomes a necessary part of its case-in-chief. As is the case with respect to the carrier's statement on community impact, interested persons may comment on the environmental statement or petition for investigation. In short, we are of the opinion that South Dakota's apprehension that the Commission's environmental decision will be grounded only upon a consideration of the carrier's partial and possibly inaccurate data is totally unfounded.

Several suggestions which we believe have merit have been made for the inclusion of additional information in the abanconment application. We will amend section 1121.32(b)(1) of the regulations to require that the applicant include in its statement of the condition of the line a description of any operating restrictions currently imposed. Section 1121.32(c)(8) will be modified to require a statement of any important changes in train service effected in the 5 years preceding the filing of the application. Finally, section 1121.32(e)(4) will require the applicant to recite any efforts it has made to continue service through the solicitation of traffic or by seeking a buyer or subsidizer for the line. This information will assist

the Commission in developing a full understanding of the conditions surrounding the filing of the application. Perhaps more important, it will provide persons interested in purchasing the line or in offering a subsidy with background information which would be of material help to them in making their decision.

The Railroad Task Force for the Northeast Region, Inc., asks that applicants be required to include a history of the ownership of the line and of any leases, and a description of any reversionary interests. We recognize the value of this information, particularly for a community considering whether railroad property would be suitable or available for some public use, but we believe that imposing a requirement as broad as has been suggested would result in placing an undue burden upon the applicant. We will, however, provide in section 1121.32(e)(5) that the applicant disclose any restrictions upon the title to the properties, including any reversionary interests, of which it may be aware which would affect the transfer of title or the use of the properties for other than rail purposes.

Service and filing of the application.—Several of the parties express concern that a copy of the application might not be served upon all interested persons. As initially proposed, in section 1121.34(d) the carrier would be required to file an application with the Commission, the Governor of the affected State, the Public Service Commission (or equivalent agency), and the designated State agency. The carrier was further required to serve a copy upon any person submitting a petition for investigation or written comments. We have revised this section to require that, in addition to serving the above mentioned persons, the applicant furnish upon request, by first-class mail, a copy of the application to any interested person proposing to comment or petition for investigation. This addition is primarily designed to accommodate those persons who are unsure of their specific interest in the proceeding at the time of filing and may not wish, upon review of the application, to be shown as parties. However, we have also provided that copies of the application be deposited at places where the regulations require posting of the notice as specified in section 1121.34(c) and (d). We do not envision any significant increase in the burden imposed upon the applicant since we expect that anyone anticipating an interest in the proceeding will utilize the provision for filing comments.

BRAC and RLEA intimate that unless its officers receive copies of the application at the time of filing they might not have sufficient

time to determine *not* to file petitions opposing abandonments. Under the revised regulations, BRAC, RLEA, or any other interested person need simply request, upon notice of the carrier's intent to file an abandonment application, that it be served with an application. Since the notice of intent must be published during the 30-day period prior to the actual filing, and service thereof must be completed at least 15 days prior to filing, we believe any interested person, including the labor organizations, will have ample time to make its request upon the carrier and formulate its comments or petition to investigate.

A number of comments received were in support of section 1121.34(e)(1) providing for the rejection of applications not in compliance with these rules. Many of the participants suggested modifications providing for mandatory rejection, a statement of reasons for the rejection, a means for the public to alert the Commission to defects in the application, service of the rejection order on parties to the proceeding, or allowance for the revision and resubmittance of the application within a reasonable time. All these provisions are already provided for in the regulations or are traditional procedures for the Commission.

M-K-T claims that this regulation could constitute a severe penalty for failure to comply in some minor matter. We disagree. This authority is no less than that always possessed by the Commission. Furthermore, opportunity is provided for the submission of a revised application. Nevertheless, since section 1a(3) of the act provides that the 60-day period the Commission has to issue a certificate in an uncontested and noninvestigatory proceeding does not begin to run until there has been submitted a completed application, it is conceivable that a carrier required to continue operations during the delayed period might view the requirement as a penalty. However, as we view it, if this is indeed a penalty, it certainly is not a severe one in light of the resubmission provision and it is one the carrier may very easily prevent in the first instance.

Although we feel it goes almost without saying, there is one other point of confusion we are constrained to clarify in response to several comments received. If the application is incomplete, its filing defective, or proper notice is not provided, our order rejecting the application will state the reasons therefor. In addition, all parties to the proceeding will receive service of the rejection order as part of the standard procedure for all administratively final orders. The regulations have been revised accordingly.

Participation in abandonment proceedings.—Under proposed section 1121.36, a person could file either a petition to investigate or a written comment within 45 days of filing of the abandonment or discontinuance application to become a party to the proceedings. The notice of proposed rulemaking stated that an investigation will be instituted upon receipt of a petition to investigate or may be instituted on the Commission's own initiative. Written comments were to be considered in this determination but would not, of themselves, be deemed to require an investigation. This wording has apparently prompted significant misunderstanding in two respects not intended by the Commission: (1) that the Commission has discretion with respect to instituting an investigation if a petition to investigate is filed, and (2) that comments and petitions to investigate are substantially the same and that either will automatically trigger an investigation. The regulations, and certain aspects of the notice of intent, have been modified for clarification. Moreover, several additions have been made to emphasize the distinctive role petitions and comments will play in abandonment and discontinuance proceedings.

Section 1a(3) of the act provides that the Commission *shall*, upon petition, or may upon its own initiative, cause an investigation of an abandonment proposal to be conducted. As we interpret that language, if a petition to investigate is filed—by any person—we have no discretion but to institute an investigation. The congressional intent could hardly be clearer, and we intend to follow the language of the statute.

It is because the institution of an investigation is mandatory upon the filing of a petition to investigate that we provided for the filing of comments as an alternative means for interested persons to become participants to an abandonment proceeding. Those who have some objection to the abandonment proposal which they believe can be met by the imposition of a condition to which the applicant would agree, or who simply seek clarification of some point in the application, would be able to take the "comment" route, and thus have the opportunity to make their views known without requiring the institution of a full-scale investigation.

One example of the anticipated use of comments would be in the request for the imposition of labor conditions. Traditionally and invariably, the railroad labor organizations make this request in all abandonment proceedings. Since the development of the "New Orleans" and "Burlington" conditions, such requests have been granted and conditions imposed, generally without opposition.

Because of the requirement of section 1a(4) of the act, there is obviously no need to institute an investigation in such a case. The regulations have been revised to clarify the Commission's position in this regard.

Several parties have raised the possibility that petitions to investigate might be based upon frivolous objections, resulting in the institution of investigations costly to all parties. AAR and DOT have suggested that the proposed regulations be amended to require all petitioners to reveal their interest in the proceeding, and for petitioners who are shippers, to include a description of the business for which a transportation need exists, a description of the petitioner's facilities to handle shipments by other modes, data concerning volume of traffic shipped and received by each mode for 2 years, and various other data reflecting the interest of the shipper. In addition, AAR requests that the proposed regulations be amended to allow a carrier to file a reply to petitions and comments.

Although we agree that information about a petitioner's interest should be provided, we think that the requirements of the proposed regulations were generally adequate for this purpose. In our view, the legitimacy of the petition is effectively established by its submittal as a verified statement. To require the detailed information which DOT and AAR suggest be included could well discourage the filing of legitimate petitions.

Finally, we are revising the proposed regulations to allow for replies to comments and petitions. To facilitate the submission of replies, to both comments and petitions, we have reduced the period for filing from 45 to 35 days. Replies must be filed with the Commission within 45 days of the date the applicant files its application for abandonment. We fail to see any merit in BRAC's and RLEA's contention that 45 days for filing comments or petitions renders impossible the deliberative consideration of an abandonment application by an interested party. As discussed elsewhere in this report, if an application is opposed a certificate of public convenience and necessity permitting the abandonment or discontinuance may not be granted if the carrier had not listed that particular branch line on its system map in category 1 for 4 months prior to filing of the application. At a minimum, interested persons effectively have 120 days advance notice of the filing; hence, at least that much time is available to determine what action, if any, they intend to take. The notice form has been revised to reflect the new time periods.

Financial assistance procedures.—Extensive comments were received on this aspect of the proposed regulations, which appeared as section 1121.38. However, we believe that only minor modification and clarification of this section are necessary.

As initially proposed, section 1121.38(a) provided that the Commission publish its findings that public convenience and necessity permit abandonment or discontinuance in the Federal Register, as notice to persons contemplating offers of financial assistance to assure continued rail service under section 1a(6) of the act. AAR believes that some ambiguity exists as to when the Commission's public convenience and necessity findings would become administratively final, and is of the opinion that this ambiguity results from the Commission's dual task of finding public convenience and necessity and providing an opportunity for subsidies. It suggests a redraft of this section, the principal effect of which would be to make the 30-day time period of section 1121.38(f) run concurrently with the period for petitions for reconsideration of the Commission's finding of public convenience and necessity. This was not the purpose of proposed section 1121.38(a), and we believe that AAR's proposed clarification is inappropriate. The section will be modified slightly to indicate clearly that it envisions publication of administratively final findings and subsequent, not concurrent, procedures under section 1121.38(f). As revised, it will read as follows:

(a) In any proceeding in which the Commission finds, after investigation or without such investigation, that the present and future public convenience and necessity permit or require the proposed abandonment or discontinuance of rail service, the Commission will, prior to the issuance of an effective certificate authorizing the abandonment or discontinuance, publish such findings in the Federal Register as notice of a final opportunity to persons intending to offer financial assistance to assure continued rail service under section 1a(b) of the act and pursuant to this section of the regulations. This Federal Register Notice will be published when the proceeding is administratively final.

A substantial number of comments were received on proposed section 1121.38(b)(1)(i) which would require that an offer of financial assistance be filed and served no later than 15 days after the publication in the Federal Register of the Commission's findings of public convenience and necessity required by section 1121.38(a). Numerous parties, including Iowa, South Dakota, RLEA, and BRAC claim that this 15-day time period is too short, that receipt of the applicable Federal Register cannot be guaranteed, or that not all potential offerors even receive the Federal Register. The Western Region of the National Conference of State Railway Officials

(Western Conference) would have notice of the Commission's findings sent directly to all parties of record, while AAR would leave the proposed section unchanged.

We believe that it is not necessary to alter the requirement that all offers of financial assistance be filed within 15 days of publication of findings in the Federal Register. In fact, to do so would seriously jeopardize the Commission's ability to make its statutory findings, under section 1a(6) of the act, that a financially responsible person has offered financial assistance to enable the rail service to continue and that such an offer meets certain cost criteria. Such findings must by statute be made within 30 days of publication in the Federal Register. A minimum of 15 days will be necessary for the Commission to give conscientious consideration to its decision on the offer of financial assistance, and to extend the number of days allowed offerors of financial assistance would further reduce this already compact time period.

We believe that such a time table will not be unduly burdensome to potential offerors of financial assistance for several reasons. Interested persons will have notice of the abandonment filing, since the line involved must be in category 1 on the system diagram map and that fact publicized in newspapers of general circulation in the affected counties. Notice of intent to abandon a line or discontinue service will be served on the Commission, certain State officials and agencies and significant users at least 15 days prior to actual filing of the application. Additionally, proposed section 1121.38(b)(1)(i) provides that an offer may be filed and served at any time subsequent to filing of an abandonment or discontinuance application. Finally, provision will be made so that the order issued under section 1121.38(a) will inform the parties of the date on which offers of financial assistance must be filed pursuant to paragraph (b). Considering the time which interested persons have to plan and make an offer under the regulations promulgated herein, we believe that the direct notice proposed by the Western Conference and the proposed changes in section 1121.38(b)(1)(ii) are unwarranted.

AAR and DOT believe that the contents of the offer of subsidy as required by paragraphs (b)(2) and (3) are redundant, and that governmental entities should be required to supply the additional financial responsibility data. We disagree. First, we believe that the information required by these two paragraphs is essential if the Commission is to make the required statutory findings that a firm subsidy offer has been made and that it has been made by a financially responsible person. Second, we think that the requirements of paragraph (b)(2) are sufficient to inform us of the financial resources and funding authority of a Government entity.

The detailed balance sheet and income statement data required of nongovernment entities under paragraph (b)(3), while appropriate for private businesses and individuals, are, in our view, unnecessary to the making of our determination of the financial responsibility of a State or local Government or Government agency.

The possibility exists that certain offerors of financial assistance would desire to make a subsidy payment to encompass operations over only a portion of the line for which a finding of public convenience and necessity has been made. Paragraphs (d)(1) and (2) provide for partial acquisitions of lines and a mechanism for the offeror to obtain information relevant to the cost of a partial acquisition. Paragraph (c)(1) will be modified to provide for offers of subsidy for portions of lines and the procurement of data to make such offers. Also, a new subsection (g) will be added providing that "offerors may request, and carriers shall provide, an estimated subsidy payment reflecting operations of less than the entire line." These changes should facilitate offers of subsidy for portions of lines, where it would not be economically viable to subsidize the entire line sought to be abandoned.

The addition of subsection (g) will result in a renumbering of subsections (g) through (i) to subsections (h) through (j).

AAR has questioned the silence of the proposed regulations with respect to the question of rail service continuation payments during any period of negotiations between a carrier and the offeror of financial assistance. It believes that any party that desires rail service continued at the carrier's expense could make an offer meeting the requirements in section 1121.38(f)(1) and, by submitting the material required in section 1121.38(b), could prolong unprofitable rail service, at the carrier's expense, for as long as 6 months. This, AAR suggests, would provide a powerful incentive for offerors to delay reaching an agreement until near the 6-month deadline.

AAR requests that the proposed regulations be amended to provide that offerors of financial assistance be made responsible for paying the difference between the revenues attributable to the line and the avoidable cost of providing service on the line, plus a reasonable return on the value of the line, from the date the Commission postpones issuance of a certificate authorizing abandonment or discontinuance. If agreement were reached, payments would be made retroactive to this date. Where no agreement was reached, the offeror would be bound to pay the carrier's shortfall on the line during the period in which negotiations continued, according to the Commission's own determination of the amount of shortfall under section 1121.38(f)(1). AAR would further

extend this to offers to acquire lines by making offerors pay interest on the agreed upon value (or, where negotiations fail, on the Commission-determined value) of the line from the date of the Commission's postponement of certification until the date of closing. AAR states that this conforms to the intent of section 1a(6)(a)(1) of the act to make the carrier whole from the date of issuance of the certificate. In its reply DOT basically agrees with this position.

We are in complete disagreement with the positions of AAR and DOT, and are firmly convinced that the statute contemplates the operation of the line, without financial assistance, until an agreement is reached, or a certificate issued. Section 1a(6)(a) of the act states that the Commission "shall postpone the issuance of a certificate of abandonment or discontinuance for such reasonable time, not to exceed 6 months, as is necessary to enable such person or entity to enter into a binding agreement, with the carrier seeking such abandonment or discontinuance, to provide such assistance or to purchase such line and to provide for the continued operation of rail service over such line."

Common carriers by railroad have a statutory duty to perform service over their lines until issuance by the Commission of a certificate of public convenience and necessity authorizing abandonment of the line or discontinuance of operations. The statute envisions a delay in issuance of such a certificate pending negotiations of offers for financial assistance. During this period, the carrier is still under its common carrier obligation to perform service. We are unable to find in the legislative history, or in the clear wording of the statute, any indication that Congress intended to make financial assistance available to the railroad during this maximum 6-month period or to relieve the railroad of its statutory obligation to perform service at its own expense. To clarify this, the following sentence will be added to section 1121.38(f)(1)(ii): "During the negotiation period, or in any event no longer than 6 months, the carrier shall continue to provide service at its own expense."

A number of comments addressed proposed section 1121.38(h)(2)[1] of the proposed regulations, which provided as follows:

(2) If during the 6-month negotiation period the parties are unable to execute a financial assistance agreement, the Commission may—

[1] In the regulations being adopted, this provision has been redesignated as section 1121.38(i)(2).

(i) Issue a final certificate at the end of the 6-month period which shall become effective and may be conditioned in accordance with the provisions of section 1a of the act and these regulations;

(ii) Reopen the underlying abandonment or discontinuance proceeding to reevaluate the application on its merits in light of the financial assistance offer;

(iii) Direct the carrier to continue to provide rail freight service for an additional year in return for compensation to be computed by the Commission from its earlier determination under section 1a(7) of the act, as modified to reflect current circumstances, and in accordance with the standards established in subpart D of these regulations; or

(iv) Take whatever action is appropriate to the particular situation and in conformity with section 1a of the act.

The majority of those commenting on this provision were concerned about paragraph (2)(ii) and the possibility that the Commission might reopen the abandonment or discontinuance proceeding to reevaluate the application on its merits in light of the financial assistance offer, if no binding agreement had been reached between the parties. AAR believes that section 1a(6) of the act does not give the Commission the power to reopen the abandonment proceeding in such a situation; that the statute clearly indicates that issuance of a final certificate can only be postponed for a reasonable period, not to exceed 6 months, if no binding agreement is reached; and that, the Commission's action, as contemplated in proposed paragraph (2)(ii), would flout congressional intent. DOT and M-K-T see no reason to reopen the underlying abandonment application simply because negotiations for an offer of financial assistance have failed. Maryland feels that additional legislation is necessary to require a carrier to continue rail service over a line for which a reasonable subsidy has been offered. Iowa suggests that the act be amended to require that the Commission adjudicate the offer of financial assistance if the parties fail to reach an agreement. DOT would amend paragraph (2)(iii) to allow the Commission to order the continuation of operations for 1 year if the railroad refuses to accept the subsidy offer it has calculated, and an alternative section where, if negotiations were stalemated, an extension of time could be granted and the Commission could determine the necessary subsidy amount. The offeror would then have 1 week to accept or reject that subsidy figure. If rejected, the line could then be abandoned.

The comments received clearly indicate that the parties, are concerned that the Commission does not have the power under the act to reopen the underlying abandonment or discontinuance proceeding as proposed in subsection (2)(ii). However, we are

confident that the Commission has such power, and will briefly discuss how the four alternatives in paragraph (2) (i)-(iv) will be used to further the intent of Congress to establish an abandonment and discontinuance process that would facilitate the financial assistance program.

The statutory authority to reopen the underlying abandonment or discontinuance proceeding is found in newly enacted section 17(9)(g) of the act: "the Commission may, at any time upon its own initiative, on grounds of material error, new evidence, or substantially changed circumstances—(i) reopen any proceeding; (ii) grant rehearing, reargument, or reconsideration with respect to any decision, order, or requirement; and (iii) reverse, modify, or change any decision, order or requirement. The Commission may establish rules allowing interested parties to petition for leave to request reopening and reconsideration based upon material error, new evidence, or substantially changed circumstances." Thus, the clear power to reopen proceedings is contained in the act. The parties to this proceeding are essentially correct when they assert that such a reopening might tend to blur the distinction between the finding that public convenience and necessity require the abandonment or discontinuance and the Commission's determination of the appropriateness of the offer of financial assistance under section 1121.38(f). However, the offer of financial assistance and the rejection of such an offer is clearly a substantially changed circumstance under the terms of section 17(9)(g) of the act, and in some situations could be viewed as being a determinative factor in influencing the Commission's initial finding that public convenience and necessity required the abandonment or discontinuance of the line.

We emphasize that this power to reopen proceedings will be used sparingly, and only upon evidence of clear recalcitrance on the part of the applicant carrier. However, we do believe that this provision is necessary to effectuate the intent of Congress that every opportunity be afforded to preserve rail service, especially if a potential subsidizer or purchaser has made a reasonable offer of financial assistance.

Finally, some of the parties have expressed concern with the vagueness of subsection (2)(iv); however, we believe that such a provision is necessary. At this time the Commission is promulgating procedural regulations, and, because it is difficult to predict what problems could arise under section 1121.38, this subsection is essential to allow the Commission to implement the rail service

continuation procedures which were embodied in the 4R Act. Subsection (2)(iv) will be expanded slightly to read as follows:

(iv) Take whatever action is appropriate to the particular situation and in conformity with section 1a of the act. Such action may include but not be limited to setting the matter for arbitration, subject to final review by the Commission.

The Comments of the Western Conference and South Dakota to section 1121.38(j), Reservation of Jurisdiction, request that reopening be made mandatory upon termination of the financial assistance agreement. AAR believes that the Commission was correct in allowing itself discretion in reopening the proceedings. We can envision a situation where, upon termination of a financial assistance (subsidy) agreement, a line would be rehabilitated to such an extent as to seriously question the validity of the Commission's previous finding of public convenience and necessity. We are also cognizant of the fact that State Governments are somewhat concerned about operating a line over which final issuance of a certificate of public convenience and necessity has merely been postponed pursuant to section 1121.38(f) of the regulations promulgated herein and section 1a(6) of the act. We believe that the discretionary approach to reopening is more appropriate, since the Commission will be able to evaluate whether, in fact, there have been any changes in circumstances resulting from the financial assistance program. This subsection is renumbered (1) and slightly modified to read:

(1) *Reservation of jurisdiction.*—The Commission reserves the right to reopen on its own motion or on petition an abandonment or discontinuance proceeding to consider, among other things, any change in circumstances resulting from a financial assistance program which may reflect upon the merits of the abandonment or discontinuance application.

A new section, designated as 1121.38(k), will be added to outline procedures in the event of a default of the financial assistance agreement:

(k) *Default on agreement.*—In the event any party to a financial assistance agreement defaults on the obligations hereunder, then any party to the agreement shall promptly inform the Commission. Upon notification the Commission will take such action as it may deem appropriate. This subsection should not be interpreted to mean that the Commission will determine that a contractual default has in fact occurred.

Other public use.—The Railroad Task Force for the Northeast Region has requested certain changes in section 1121.39—Public Use Procedures—to facilitate preservation of lines for possible inclusion in the Fossil Fuel Rail Bank pursuant to section 810 of the 4R Act. Specifically, it requests that no certificate be issued to require that the properties listed in the USRA Final System Plan, Volume II, Part III, Section C, Lines Recommended for Consideration for Inclusion in a Fossil Fuel Rail Bank, be offered for acquisition for any other public purposes, except inclusions in such a bank, prior to the establishment of a Fossil Fuel Bank pursuant to section 810 of the act. The Secretary of Transportation has not established a Fossil Fuel Bank pursuant to section 810 at this time. While we decline to make the changes requested, upon issuance of a certificate of public convenience and necessity authorizing abandonment or discontinuance of lines recommended for inclusion in the Fossil Fuel Rail Bank, the Commission will take appropriate action to insure that the Secretary has the opportunity to exercise his options under section 810 of the 4R Act.

SUBPART D—STANDARDS FOR DETERMINING COSTS, REVENUES, AND RETURN ON VALUE

Subpart D of the proposed regulations contains the standards for determining the revenues attributable to the rail properties, the avoidable costs of providing service over those properties, and a reasonable return on the value of those properties, which are the subject of an abandonment or discontinuance application or an offer of financial assistance. The standards were based largely on the regulations (49 CFR 1125) developed for the administration of the subsidy program in the Northeast and Midwest Region.

The parties are generally in agreement with the avoidability concept reflected in the proposed standards. AAR, however, asserts that the proposed standards are incomplete and noncompensatory because they fail to recognize that portion of the common expense which varies directly with output. Contrary to AAR's contention, the proposed standards do recognize common variable costs. As the office pointed out in its regional rulemaking, while the phrase "avoidable costs" should be strictly construed, "this fact does not necessarily exclude indirect costs" (40 F.R. at 1617). The on-branch sections of the standards do not limit the railroad to recovering only its direct costs. A number of sections which prescribe apportionment methodology include indirect costs, *e.g.*,

locomotives repairs (Account 311), yard transportation (Accounts 382, 383, 388), servicing train locomotives (Account 400), and train supplies and expenses (Account 402). In addition, common variable costs are taken into account in the calculation of off-branch costs (see 40 F.R. at 1268).

DOT argues that the standards fail to consider one important area of costs; that is, "the nonvariable costs (including traditional fixed and semi-variable costs) of the rail carrier which would normally be covered by [branch] revenues." DOT argues that "unless these nonvariable costs are covered by the subsidy, unsubsidized branch lines must, in fact, cover these costs from their own revenues."

DOT's position is inconsistent with the statutory criterion of "avoidable costs." Section 1a(11) of the act provides that "the term 'avoidable costs' means all expenses which would be incurred by a carrier in providing service which would not be incurred, in the case of discontinuance, if such service were discontinued, or, in the case of abandonment, if the line over which such service was provided were abandoned." As AAR aptly puts it, section 1a(11) largely prescribes what economists would term a condition of "economic indifference"; i.e., the economic consequences to the carrier are the same whether or not service is abandoned or discontinued. DOT in effect advocates the full distribution of costs. Congress was afforded an opportunity to choose between fully distributed and avoidable cost methodology (see Senate Report 94-31, 94th Congress, 1st Session, pp. 660, 796, 804-05, 844-45). It rejected the former and enacted the latter; therefore, it would be contrary to statute to compensate the railroad for its fixed nonvariable costs.

Attributable revenues.—Proposed section 1121.41, covering determination of the revenues attributable to the branch rail properties, was patterned after similar provisions in the regional freight subsidy standards (49 CFR 1125.4). The responses addressed methods for line-specific revenue determination; the treatment of overhead traffic; traffic interchanged through junctions located on the branch; and revenues from transit shipments.

Line-specific determination.—In the notice (41 F.R. at 31882), the Commission expressed the view that, although the concepts of the regional standards had withstood court challenge, the circumstances surrounding this proceeding are sufficiently different that it would be desirable to develop an alternative method for attributing revenues to the branch in order to eliminate the necessity for determining off-branch costs. In inviting suggestions on this point, the Commission was mindful that in the congressional

hearings dealing with branch line legislation, a railroad industry representative had urged that revenues and costs for light-density lines should be associated only with the specific line segment (see testimony of J. H. Williams, Senate Report 94-31, 94th Congress, 1st Session, page 806). Although Congress did not adopt this "specific line segment" recommendation as a requirement of the act, the Commission deemed it appropriate to afford industry representatives an opportunity to implement the recommendation, and thus obviate the problems of off-branch costing.

AAR's initial response on this point was that "the industry has tested a number of alternative hypotheses for determining 'revenue attributable' to separate off-branch revenues. While some have shown promise as a basis for later development of alternative methods, we are not able at this time to suggest an alternate formula which can be given national application."

Coopers & Lybrand propose that revenues be attributed to the branch on the ratio of miles on the branch to miles on the system; initial or final switching charges would also be assigned to the branch. AAR replies that while "there is no entirely proper way to separate on-line and off-line revenues," it supports the Coopers & Lybrand approach since it would eliminate consideration of off-branch costs. However, most freight tariffs applicable to branch line traffic do not include initial or final switching charges, thus, a straight mileage pro rate would be unreasonable because it would not recognize the costs of originating or terminating traffic on the branch.

PUC and UTU suggest alternative methods: first, a mileage pro rate system involving the allocation of arbitrary 50-mile "blocks"; or second, yearly Commission publication of the average cost of originating or terminating one carload for use in calculating the total revenue to be attributed to the originating and terminating traffic. In addition, the branch line would be credited with 50 percent of the off-branch system revenue. AAR objects, properly we think, that these methods as proposed would produce arbitrary and inaccurate results, and that they lack conceptual foundation. DOT objects to the proposals of both Coopers & Lybrand and Pennsylvania PUC and UTU.

In sum, although the parties have not as yet presented a workable alternative, AAR states that it is testing alternate hypotheses, some of which show promise. Coopers & Lybrand also is making further studies. Consolidated Rail Corporation (Conrail) is conducting a number of subsidized branch line operations under the regional

freight standards and also interchanges traffic and has negotiated divisions with several other designated operators of subsidized branch lines. While not a party to this proceeding, it has informally expressed willingness to conduct experiments with alternative methods of computing branch line attributable revenues, and revision by the office of the regional standards to accommodate such an experimental program is under consideration. The results of these experiments, when available, may be expected to shed new light on this problem.

The principal advantage of developing an alternative to the present method of attributing the revenues of originated and terminated traffic would be to eliminate off-branch costing. The Commission will be receptive to future proposals which would achieve this result. Generally, such proposals should meet the same tests of justness and reasonableness as would be required of divisions of joint rates under section 15(6)(a) of the act.

Overhead traffic.—Proposed section 1121.41 would attribute revenues of bridge and overhead traffic on the basis of miles moved on the branch to miles moved on the system. AAR notes that most carrier records are not prepared in a manner which would develop internal junctions as distinct from either major gateways or interchange points with other carriers. The cost of developing programs which cover all possible routings over lines of each applicant would, it asserts, be prohibitive. Because of similar representations, and in the interests of minimizing required recordkeeping, the standards have been revised to provide that, with respect to overhead traffic, the parties to a subsidy agreement are not bound by the mileage apportionment method, but may negotiate a mutually acceptable usage fee.

AAR also argues that revenues from overhead traffic which could be retained in the railroad's system by diversion to other, possibly more circuitous routes, should not be attributed to the branch, but that any reduction in revenues or increase in expenses resulting from such rerouting should be treated as reduction of losses incurred in operating the line to be abandoned. It is appropriate to note here that section 1a(3) of the act places the burden of proof as to public convenience and necessity upon the applicant in an abandonment proceeding. Proof that traffic moving over the branch will be retained in the event of abandonment will be entitled to appropriate weight in an abandonment proceeding. However, as DOT correctly states, for subsidy purposes the question is what is the present traffic on the branch. If the branch is not actually

abandoned because a subsidy is offered, the Commission does not think it equitable to require the subsidizer to be deprived of credit for revenues from traffic either actually or hypothetically diverted from the branch for the purpose of increasing the subsidy.

Traffic interchanged on the branch.—The standards have been revised to provide that traffic interchanged at a junction on the branch will be considered as having originated or terminated on the branch, and the revenues attributed accordingly. This should resolve the problem presented by Green Bay & Western concerning its car ferry connections.

Transit shipments.—In a supplemental notice issued August 19, 1976 [Ex Parte No. 293 (Sub-No. 2)], the office proposed to amend the regional standards to clarify that the branch should be credited with the full revenue received by the carrier from transit shipments (including any transit charges collected) rather than only the revenue from that portion of the movement between the on branch originating or terminating point and the transit point. Comments addressed to this issue were received in this proceeding, and in Ex Parte No. 293 (Sub-No. 2); for the purposes of this discussion, they will be considered as if all had been submitted in this proceeding.

AAR concurs with the suggestions of South Dakota and NITL that revenues from true transit shipments should be attributed to the branch and believes that the regulations as written appropriately deal with this matter. AAR would, however, exclude revenues on proportional rated movements beyond the proportional rate point.

It is the Commission's intention that the revenues attributable to the branch, for both abandonment and subsidy purposes, should include all revenues generated by traffic originated or terminated thereon, including transit revenues; and we see no reason for excluding any revenues from proportional-rated traffic. The responses of Agway, Inc. (Agway), and of Conrail indicate that this intention is not being fully implemented in the reporting of revenues under the regional subsidy program, and that there are some practical difficulties arising out of the increasing dependence of rail managements on computerized recordkeeping , *e.g.*, that revenues on light-density line shipments afforded certain types of transit privileges could be subject to adjustment up to 2 years after original submission of the shipper's registration on the car. Therefore, Conrail asserts that the administrative costs to implement the proposal would far outweigh the slight refinement in revenue reporting which would result. Agway, however, appropriately notes that Conrail's tariffs normally include separate charges for transit

privileges which it believes are at a level sufficiently high not only to cover, but more than cover, the extra costs associated with the transit service.

Although we recognize the difficulties pointed out by Conrail, and have no desire to impose undue accounting or recordkeeping burdens, we cannot concur that the exclusion of any revenues properly attributable to the branch, for either abandonment or subsidy purposes, is acceptable. Therefore, the standard is revised to specifically require the inclusion of transit revenues.

Such traffic may be consequential to the viability of some branch lines; in other instances, it may be sporadic or nonexistent. Where a branch is used for the movement of transit traffic, the movements are likely to be repetitive and to occur with some frequency. In each case, the railroad is in possession of the relevant data. For abandonment purposes, it may satisfy its burden of proof by submitting the results of special studies, rather than detailed accounting data covering an extended period, provided that it shows such study results to be representative. For the purposes of subsidy agreements, the railroad and the subsidizer may agree to a revenue adjustment based on sampling studies or other appropriate procedures in lieu of the recording of actual detailed full transit revenues. In any event, provision for full recognition of transit revenues must be made.

AVOIDABLE COSTS OF PROVIDING SERVICE

Administrative costs.—The proposed standards allow one-half percent of attributable revenues as an avoidable cost to the railroad to cover the expenses of administering the subsidy program. AAR while agreeing in principle with this allowance asserts that administrative costs of planning, recordkeeping, conformity with Federal Railroad Administration regulations, and day-to-day services are so high that the one-half percent administrative fee is not compensatory. It specifically relies on Conrail's experience in its administration of the 142 subsidized branch lines in the Midwest and Northeast Region. AAR asserts that Conrail's total cost for the subsidy program approximates more nearly 2 percent of its revenues attributable.

Indisputably, the railroad should be reimbursed for the actual costs of the subsidy program. Conrail has raised the same issue in the proceeding involving the regional subsidy standards [Ex Parte No. 293 (Sub-No. 2)] and, an on site audit has been conducted by

the office indicating that Conrail's actual subsidy program administrative costs exceed 1 percent of its projected revenues.

In these circumstances, the best course of action would appear to be to allow the railroad to choose either to recover the actual direct costs of the subsidy program or to take a 1 percent administrative allowance in lieu of actual expenses. Specifically, the railroad would be entitled to be reimbursed for out-of-pocket expenses incurred during the subsidy period of maintaining and reporting the actual revenue, cost, and service unit data, and otherwise administering the subsidy program. It should be emphasized that the railroad may not allocate these general expenses on estimates of time expended or arbitrary formulae. Rather they must be predicated on detailed records of time spent by the persons administering the program and on invoices for services performed. Alternatively, the railroad may take a 1 percent administrative allowance in lieu of actual expenses.

Superintendence.—AAR asserts that the direct assignment of the costs incurred for supervising maintenance-of-way and structures, maintenance of equipment and transportation would require "an exorbitant amount of manual recordkeeping and clerical time." AAR deems it essential that the railroads be permitted to apportion such expenses and recommends that the apportionment be based on "tons of revenue freight" reduced to the "variability level shown in appendix F, ICC Statement ICC-73, and subsequent editions." M-K-T claims that superintendence costs "can rarely be determined on a direct basis for the normal, short branch line" and suggests that such costs be based on a "mileage pro rate."

The regional standards presently do not allow the railroad to recover any costs for the supervision of maintenance-of-way, maintenance of equipment or transportation on the branch line. This decision was predicated on the view that the amount of time that a superintendent would have to devote to a particular branch would be negligible, and therefore, his salary was not strictly avoidable. However, based on actual operating experience in the Midwest and Northeast Region, the office has recognized that a railroad operating several branch lines under subsidy may have to employ more supervisory personnel than it would in the absence of subsidized service. Therefore, it has instituted rulemaking to consider amending the regional standards to allow the railroad to recover the direct costs of supervision, based on the number of hours which a superintendent actually devotes to the branch line. The same approach is being applied in the national standards.

The Commission does not agree that it would be appropriate to apportion the common costs of superintendence between the branch and the remainder of the system. The standards already include a portion of such common costs in the off-branch cost formulae; in addition, the standards include an optional allowance of 1 percent of revenues to cover administrative costs should the railroad conclude that it is impractical to collect actual direct costs.

Structure maintenance.—AAR asserts that the railroad should be permitted to apportion accounts 227-265, excluding account 249, to assure that it will recover the common costs of maintenance of off-branch structures which are designed to and actually serve both branch and mainlines. We disagree; such common costs are taken into account in the off-branch cost calculation.

Track rehabilitation.—AAR asserts that limiting rehabilitation costs only to those necessary to reach FRA class I standards is inconsistent with statutory objectives in that it will not provide "adequate and efficient" rail service (section 5(f)(3) of the Department of Transportation Act). AAR recommends that the railroad be allowed to treat as avoidable such rehabilitation costs as are necessary to eliminate deferred maintenance and provide adequate and efficient rail freight service.

AAR misapprehends the track rehabilitation provision of the standards. It establishes FRA class I standards as a *minimum* level of service; however, if a subsidizer requests a higher level of service, which requires expenditures for track rehabilitation such expenses are properly avoidable. While it would be inappropriate to permit the railroad unilaterally to impose service levels above the minimum, the parties may mutually agree to a higher service level.

Traffic.—AAR alleges that by invoking an avoidability test for traffic expense (i.e., the railroad may recover only those direct expenses which would be avoided as a result of the service being discontinued) the standard "is written in such a way as to make it virtually impossible" to obtain reimbursement. AAR thus infers that "railroads are not expected to spend time soliciting branch-line traffic, providing rate quotations, et cetera."

AAR's inference is incorrect. We expect the railroad to make a conscientious effort to maximize branch line traffic in consideration for reimbursement for its net avoidable costs, plus payment of a reasonable return on its investment. We do not believe a railroad would be justified in ignoring or diverting branch line traffic merely because it did not subscribe to the avoidability theory of compensation adopted by Congress. The railroad is entitled to

recover actual traffic costs directly attributable to the branch. It is not entitled to allocate common traffic costs which it would continue to incur if service on the branch were to terminate.

Other matters.—Based on the suggestions of the parties and the experience derived from operation of branch lines under subsidy in the Midwest and Northeast Region, the national standards have been revised in the following respects to cover more completely the avoidable cost of continuing service:

a. *Running overhead from yard to branch; deadheading; taxi, and hotel costs.*—These categories of costs arise because of the location of, or the nature of the service required over the branch line. For example, it may be necessary for an engine crew and locomotive to run overhead from a yard, performing no work along the way, to reach a branch line which is the only duty assignment of the crew outside the yard. In these circumstances, the on-branch costs for crew, locomotive, and car costs per mile should reflect the overhead time and mileage. The off-branch costs per car mile must, however, be adjusted to exclude the overhead mileage. Deadheading, taxi, and hotel costs ordinarily would be included in wage accounts. The standards have been revised to require these costs to be maintained separately from wages to facilitate auditing.

b. *Specialized equipment costs.*—The proposed standards are silent on the costs incurred for operating specialized locomotives and other equipment dedicated exclusively to serving the branch line. They have been revised to allow the actual repair and other costs of specialized equipment which are not used to serve any other portion of the railroad's system.

c. *Roadway machines and tools (Accounts 269 and 271).*—To minimize recordkeeping and clerical time, roadway machine and small tool maintenance costs will be assigned to the branch in proportion to roadway maintenance costs (Accounts 202-220).

Capital related items.—In the notice (41 F.R. at 21882-3), the Commission proposed that the investment base for computing the "reasonable return" under section 1a(6)(A) of the act should consist of three elements:

(1) Working capital reasonably necessary for continuing the branch line operations, as contrasted with terminating them;

(2) Federal or State tax benefits foregone or deferred as a consequence of deferring retirement of properties proposed for abandonment; and

(3) The value of the properties held in service.

While the parties did not dispute this basic approach, several did suggest changes in the standards for computing certain capital-related elements of the avoidable costs and return on the value.

Allowable working capital.—Proposed section 1121.43(a) of the standards would allow working capital in the investment base equivalent to 15 days of on branch cash avoidable costs (on branch avoidable costs less depreciation). In the notice (41 F.R. at 31883) the Commission observed that "the present practices of the railroads and their reports to the Commission do not provide a reliable basis for determining precise allocations of working capital to branch lines," and invited specific suggestions of the parties as to the proper allowance. Iowa asserts that "over a given year the amount of capital needed to sustain branch line operations will probably fall in the neighborhood of between $2,000 and $10,000 per mile per year," but does not offer any basis for this estimate. It does urge the Commission to carefully reassess its theory in the light of the practical ramifications.

AAR estimates that 50 percent of all rail shipments are interline; that interline settlements are usually 3 months late; that the remaining shipments are settled within 30 days; and that accounts payable average a delay of 30 days in payment. It therefore suggests that 30 days of on-branch avoidable costs should be defined as allowable working capital. The Commission is not persuaded that it should adopt AAR's approach, since in some instances shipments originating on a branch, whether local or interline, will be prepaid; and in other instances terminating shipments will be collect. In either of these circumstances the carrier has almost immediate possession of the funds, and is the beneficiary of any delays in interline settlements.

In sum, the responses do not measurably improve the evidentiary basis for establishing a uniform working capital allowance for branch lines. Section 1121.43(a) therefore will become effective without revision. It may eventuate that a proper working capital allowance will vary from branch to branch, depending upon the balance of the on branch traffic as between collect and prepaid shipments, the length of the off branch haul, and other considerations. There will be opportunity to revise the allowance should experience gained in actual case-by-case abandonment proceedings demonstrate the necessity.

Deferred Tax Benefits.—Proposed section 1121.43(b) of the standards would provide for allowance in the investment base of the

amount of current income tax benefits resulting from abandonment of the line which would have been applicable to the period of the subsidy agreement (this information to be furnished by the railroad and subject to audit by the person offering the subsidy). The notice (41 F.R. at 31883) contained a discussion of this item, and specifically requested comment of the parties with respect to the proposed treatment of it. The responses do not provide any substantive reason for revising section 1121.43(b).

Pennsylvania PUC and UTU:

> the carrier cannot claim both the foregone tax benefit accruing from the abandonment of the property and at the same time seek a return on the investment of the not abandoned property ***. The carrier has only two choices: abandon the line and claim the tax benefit or retain the branch and claim a return on the liquidation value of the property. In any case, the carrier cannot claim both.

We believe Pennsylvania PUC and UTU to be in error. Section 1(a)(6) of the act clearly contemplates that the carrier is entitled to be reimbursed for the avoidable costs of continuing service, including tax benefits foregone, and to receive as well a reasonable return on the value of the properties used in continuing the service. Were the carrier to abandon the line, it would realize cash from liquidation of the properties and also, depending on its tax status, certain tax benefits. If it is required to continue the service, it should be compensated for deferring the realization of these cash flows.

South Dakota asserts "there is something basically wrong with regulations that require a railroad to abandon a line before it can depreciate it for tax purposes," noting "that even the new accounting standards fail to address this problem." Although this comment should more appropriately be addressed to the proceeding in docket No. 36367, *Revision to the Uniform System of Accounts for Railroads*, we would observe that this Commission has no jurisdiction over the Internal Revenue Code or the regulations issued thereunder.

Values of the properties.—Proposed section 1121.43(c) would provide that the value of the properties to be included in the investment base should be the net liquidation value, for their highest and best use for nonrail purposes, of the rail properties on the line to be subsidized which are used and required for performance of the service requested by the person offering the subsidy. A discussion of this section is included in the notice (41 F.R. at 31883), and need not be repeated here.

AAR refers to the proposal in the office's supplemental notice (Ex Parte No. 293 (Sub-No. 2)) to amend the regional freight subsidy standards (49 CFR 1125.6—1125.7) to provide for alternative compensation resulting from arms-length negotiations. It urges that a similar provision be included in the national standards. DOT, in its response to the office's supplemental notice, recommends that the office not change the standard for determining compensation to the trustees of the bankrupt railroads for use of their properties.

As a general principle, the Commission and the office would expect to harmonize the regional subsidy standards and the national standards prescribed herein. However, there are factual and statutory differences which necessitate some variations. In large part because of litigation pending before the Special Court under section 303 of the Regional Rail Reorganization Act of 1973, the trustees of the debtor estates involved in that litigation and the subsidizing entities have been unable to reach agreement with regard to valuation of branch line properties, but may be able to agree on a reasonable alternative basis of compensation for use of the properties. No such problem exists with respect to branch line properties affected by the regulations under consideration here, and therefore, no reason is presently perceived for revision of section 1121.43(c) to accommodate alternative compensation.

Reasonable return—carriers not in reorganization.—Proposed section 1121.44(a) would provide that a carrier not in reorganization shall furnish to the Commission and to any financially responsible person considering the offer of a rail service continuation payment, a statement, with substantiation, of its current cost of capital, after adjustment for the effects of current Federal and State income taxes. The reasons for this section were discussed in some detail in the notice (41 F.R. at 31883-4), and the comments of interested parties were specifically sought.

The responses to this proposed section are in distinct contrast. Iowa concurs with the Commission's approach in establishing "the cost of capital." M-K-T fears that the standard as proposed could produce various methods of computation and many versions of its proper meaning, and urges that a specific definition and means of determination should be set forth in the proposed regulations. It recommends that cost of capital be determined by averaging the interest paid on all borrowings of the applicant over the most recent 3 calendar years. Pennsylvania PUC & UTU recommend somewhat similarly that the average annual cost of the individual carrier's

outstanding bonds should be used in determining the rate of return on the value of the property for other than equipment.

AAR, on the contrary, interprets the proposed standard to exclude any consideration of return on equity, although no such exclusion is intended. It recommends that the regulations be made explicit to include "the *current* cost of debt, the *current* cost of equity capital, and the debt and equity portions of a capital structure *which the applicant should attain or preserve if it is to have a creditable* financial stature" (emphasis supplied). As a general observation, AAR construes section 1a(11) of the act to describe "what economists would term a condition of economic indifference; i.e., that the economic consequences to the carrier are the same whether service is abandoned or continued with the described subsidy." We think this is a fair interpretation.

The Commission is aware of the unsatisfactory financial and physical condition of some railroads, and is concerned that, as pointed out in the notice (41 F.R. at 31884), the railroads have not endeavored in recent years to obtain equity capital. In instances where capital structures contain undesirable ratios of debt to real equity, the reasons are undoubtedly many and varied, extending back over the years and not necessarily restricted to the effects of branch line operations. In some cases improvident dividend or other financial policies may have played a part; in others the control of the equity by parent holding companies or conglomerates may have inhibited its marketability.

To require, as AAR urges, that the subsidizers of branch lines assume the burden of rehabilitating excessively debt-heavy financial structures, regardless of the factors leading to such structures, and regardless of the financial results from other segments of the carrier's operations, would not place the abandonment versus subsidy decisions in a posture of economic indifference. Rather, it would establish an incentive for abandonments by requiring those desiring continued service to cross-subsidize the carrier's other rail operations through provision of an assured return higher than that which may be achievable in such other operations.

Section 15a(4) of the act, as amended, requires this Commission to develop and promulgate, after notice and opportunity for hearing, reasonable standards for the establishment of revenue levels adequate under honest, economical, and efficient management, to cover total operating expenses, including depreciation and obsolescence, plus a fair, reasonable, and economic profit or return (or both) on capital employed in the business. The general theories

advanced by AAR, if adequately substantiated, might appropriately be considered in the proceedings to be conducted under that section, or in Ex Parte No. 271—*Net Investment—Railroad Rate Base and Rate of Return*.

The suggestion of M-K-T has considerable merit; and certainly the subsidy processes would be simplified if a uniform rule for cost of capital could be specified as applicable to all cases. However, section 1a(11)(b) of the act clearly envisages that the Commission shall determine the cost of capital for each railroad not in reorganization whenever an offer of subsidy is made, and that determination should include appropriate consideration of all capital elements, including debt and equity. Section 1121.44(a) requires the carrier to furnish such information, with substantiation, as will permit a case-by-case determination to be made.

As in the case of the working capital, it is to be hoped that as abandonment and subsidy cases proceed, more reliable information will be developed with respect to the capital needs of individual carriers. Prospective applicants should refer to the notice (41 F.R. at 31883) which describes some of the principal considerations which it is believed should enter into the cost of capital determinations.

Reasonable return—railroads in reorganization.—Proposed section 1121.44(b) would provide that, for a carrier in reorganization, the cost of capital shall be the average yield on all railroad bonds for the week immediately preceding the execution of the subsidy agreement, as quoted by any standard investors' service, adjusted for the effects of Federal or State income taxes, if any, actually incurred during the term of the agreement. AAR proposes that the standard be revised to read:

> For a carrier in reorganization, the cost of capital for the purpose of the rail service continuation payment shall be the mean cost of capital of railroads not in reorganization, after adjustment for the effects of current and deferred Federal and State income taxes. The ratio of equity capital as a portion of total capital shall be the mean ratio of all railroads and the cost of the equity portion shall be the mean cost of equity capital of all railroads. The cost of the debt portion of total capital shall be the average yield of all railroad bonds for the weeks immediately preceding the execution of the subsidy agreement, as quoted by any standard investors' service, adjusted for the effects of any Federal or State income taxes actually incurred by the carrier during the term of the agreement.

The difficulty is, as pointed out in the notice (41 F.R. at 31883) that reliable data as to the mean costs of capital for railroads not in

reorganization do not presently exist. The verified statement on this subject appended to the AAR submission states "the instability of financial and market data for even the most profitable and least disadvantaged railroads is a barrier to estimates of the cost of equity and total capital," and recommends that such estimates "should proceed from benchmarks provided by financial and market data for utilities,—particularly electric utilities and industrials having a greater financial stability and lesser financial risk." We are not persuaded that this analysis is altogether correct. Yields on tested railroad bonds in recent months have not compared unfavorably with those on utilities of comparable grade, and the stability of price-earnings ratios for some higher-grade railroad stocks compares quite favorably with that of many utilities, industrials, and conglomerates. The capital costs of individual utilities and industrials vary widely; properly weighted comparisons with them may be appropriate, but section 1a(11)(b) of the act clearly calls for the reasonable return to be based on the cost of capital for railroads, not that of utilities or industrials.

Admittedly, reliance on average railroad bond yields is an imperfect method for accomplishing congressional intent as to the return to be allowed on the branch line properties of railroads in reorganization. However, at present, we have no better data on which to base the standard. In the near future, only one railroad would be affected by this standard, and it seems undesirable to place upon it, or upon persons offering to subsidize its branch lines, the burden of establishing the "mean cost of capital of railroads not in reorganization" which apparently AAR cannot presently supply. As time progresses, and better data are accumulated on the mean cost of capital either through the abandonment and subsidy process or as a result of the other studies of railroad capital costs and needs now under way or to be undertaken, the standard can be revised.

Income tax effect.—Proposed section 1121.44(c) would provide that the return on investment be adjusted annually to reflect the carrier's actual current (cash) effective Federal and State income tax rate. A discussion of Federal and State income tax effects was included in the notice (41 F.R. at 31884).

AAR's position on this subject is somewhat unclear. It states that "because of the character of the taxable transactions which will occur as a result of continued operation of an unprofitable line under subsidy, the standard as proposed by the Commission is noncompensatory. To avoid this noncompensatory standard, the

marginal or statutory income tax return [sic] is the appropriate return to be used ***." Apparently AAR is suggesting that the return element should contain allowance for accruals by the carrier against deferred taxes which may become payable at some time in the future.

Our disposition of this matter closely coincides with the recommendation of an industry representative, J.H. Williams, in testimony given on July 18, 1975, before the Senate Subcommittee on Surface Transportation, which was then considering legislation dealing with branch line problems. Mr. Williams proposed that "taxes *actually incurred* by operating carriers can be calculated (either after the year of subsidy or projected for it) by: (1) calculating income taxes *actually paid* for the year of subsidized operation, and, if greater than zero, (2) calculating the income taxes which the carrier would have paid if it had not operated the subsidized lines, and (3) comparing these calculations in order to calculate the income taxes *actually incurred*" (emphasis supplied) (Senate Report 94-31, 94th Congress, 1st Session, pp. 798-807).

We believe we are entitled to rely on the views of this cost witness insofar as they are not controverted by the terms of the legislation. Witness Williams advocated allowance for income taxes actually paid during the subsidy year as compared with those which would have been paid had the service not been provided, not accruals for taxes in some future year. Section 1121.43(b) of the standards includes deferred tax benefits realizable had the line been abandoned rather than continued under subsidy (steps (2) and (3) of his recommended procedure) in the investment base on which the reasonable return is computed. Proposed section 1121.44(c) contemplates adjustment of the return for the income taxes actually paid for the year of subsidized operations (step (1)).

Capital costs associated with locomotives and freight cars.—Proposed section 1121.42(c)(4) deals with allowances for depreciation of locomotives and freight cars, and proposed section 1121.42(c)(6) and 1(3) with return on investment in such rolling stock. The discussion of the responses concerning these capital-related items is divided under three headings: (a) depreciation; (b) investment base and (c) allowable return.

(a) *Depreciation.*—AAR correctly points out that the standards calculate depreciation on the basis of an allocation of book depreciation, and it urges, in substance, that they be revised to compute depreciation as if all the equipment used on subsidized

branch lines were newly purchased at the beginning of the subsidy period. Its argument is founded in part on the reference in section 1a(11)(a) of the act to "the current cost of freight cars, locomotives and other equipment," and on the following reasoning:

> The likely effect of an abandonment would be that the rolling stock released from serving a branch's customers would displace purchases of new rolling stock of similar kind and capacity. In other words, if 100 freight cars and 10 locomotives were required in order to provide continued branch line service under subsidy, cessation of that service would permit the operating carrier to avoid the purchase of 100 new freight cars and 10 new locomotives.

This Commission is aware of the problems faced by all industry in these inflationary times, in providing for the replacement of facilities and equipment acquired at lower prices than are currently prevalent; and of the arguments for adoption of "replacement cost" depreciation accounting. The Securities and Exchange Commission recently adopted regulations requiring some companies to report separately the effects of replacing facilities and equipment at current costs; it has not required the adoption of replacement cost accounting in financial statements and, so far as we are aware, no regulatory agency has adopted it for ratemaking purposes. AAR, it may be noted, has gone beyond even the "current cost of replacement in kind" theory; it would have us assume, for subsidy purposes, that all equipment furnished to branch line shippers, no matter how decrepit or obsolete, is newly acquired and modern in all respects.

Section 1a(11)(a) of the act provides that "such foregone cash inflows and incurred outflows shall include***(iii) the current cost of freight cars, locomotives and other equipments ***." Depreciation charges do not represent current cash inflows or outflows, and there is no indication that in this section Congress intended to break new ground by legislating replacement-cost depreciation accounting. The argument that abandonment of branch lines would relieve the necessity of purchasing new locomotive and cars is unpersuasive. The same effects would be achieved by failure to supply cars to main-line shippers and the equity of imposing upon branch line shippers the alternative of paying for depreciation of fictitious new equipment which they do not receive, or losing the service, is not readily apparent.

(b) *Equipment investment base.*—The investment base to which the allowable return is applied flows from the computation of original cost less accrued depreciation. DOT states that it has

petitioned the Commission to institute a proceeding to evaluate the basis of valuing assets. In effect, it appears to favor the cost of reproduction new less depreciation as the basis for valuing assets, a position seemingly at variance with its views in Ex Parte No. 293 (Sub-No. 2). It concedes that such a change would require a change in the cost of capital standard, so that the inflation factor would not be reflected twice.

DOT's proposal for valuing assets would have far-reaching consequences; we believe that it would be more appropriately considered in a general proceeding involving all users of rail service, rather than a rulemaking proceeding limited to the prescription of branch line abandonment and subsidy standards.

(c) *Allowable return—equipment investment.*—Proposed section 1121.42(c)(6) and 1(3) of the standards dealt with the allocation to the branch lines of the allowable return on the railroad's system investment in locomotives and freight train cars. In each case, the return was to be computed by applying to the system net book investment in each class of equipment a rate equal to the rate of interest which applied to the latest equipment trust certificates, conditional sales agreements, or equipment lease agreements entered into by the railroad for the purchase or lease of such rolling stock.

AAR objects that these proposed standards fail to allow the operating carrier to recover its full cost of capital for rolling stock by providing only for interest on debt and not equity. It proposes no specific alternative, but urges that "the applicant's cost of capital applicable to freight cars, locomotives, and other equipment is no different than that which must be recovered by the enterprise as a whole." No substantiation is provided for this statement, which appears to be at variance with experience and observation.

Among the numerous factors entering into the cost of capital for any enterprise are the uses to which the capital is to be put, the security or collateral which can be provided, and the period of time for which the capital is committed. The effects of the latter two factors have been particularly notable in the behavior of the capital markets during recent years, when both quality and term yield spreads have fluctuated considerably. In these respects, equipment financing enjoys several advantages as compared with mortgage debt, debentures, or equity. Specifically, mobile security can be offered, and under section 77(j) of the Bankruptcy Act the equipment, as distinguished from other types of collateral, can be readily repossessed. The term of the debt is specific, usually much

shorter than the anticipated useful life of the equipment; and there is usually provision for at least semiannual amortization. Also, in many instances investment tax credits which cannot be used to reduce the carrier's income taxes are employed to reduce the effective interest rate. We cannot conclude, therefore, that the cost of capital for railroad equipment is the same as the cost of other railroad capital.

AAR is correct that the railroad should receive a return on the equity in its rolling stock. The proposed standards were not intended to exclude such a return. The standards apply to the entire net equipment investment the same *rate* of return, in the belief that this would have the advantage of simplicity and minimize paper work. However, inasmuch as the rate specified is the interest rate applicable to the carrier's most recent equipment obligations, rather than the average yield on all such outstanding obligations, and the carrier's actual interest payments are deducted before computing taxable income, the result of this process would be an effective return on the equity portion of the equipment investment substantially higher than this overall rate.

DOT's reply to AAR's initial statement notes that the interest rate on the most recent equipment obligation is observable and easily checked, thereby reducing the time spent on verifying the cost of capital figure and recommends that it be retained. The proposed standards will be made effective. If any party believes that separate rates of return for the debt and equity portions of the equipment investment are desirable, and is able to propose and substantiate a reasonable basis for computing such separate rates, subsequent revision of the standards to accomplish this could be considered.

(d) *Summation—equipment.*—The foregoing discussion of the return on the operating carrier's investment in equipment has involved four issues: (1) the calculation of original cost; (2) the equipment investment base allowed (original cost less accrued depreciation); (3) annual depreciation charges; and (4) the amount of the return on the debt and equity portions of the carrier's investment. For the benefit of the parties, it may be useful to illustrate in arithmetic terms the effects of the decisions which have been reached as compared with those which would have resulted from accepting the approaches of AAR as to the treatment of equipment investment.

For this illustrative purpose, it is assumed that the operating railroad has an equipment fleet variously aged 1-40 years with an actual original cost of $200 million. Book accrued depreciation is 50

percent, or $100 million, so that the net book value is $100 million. Outstanding are $50 million of unamortized equipment obligations, with coupon rates varying from 4 percent to 8 percent, the weighted average being 6 percent. The book equity in this equipment thus is $50 million. The estimated cost of replacing all of this equipment with new, modern equipment at 1976 prices is $400 million (double the original costs). AAR proposes, in essence, that for the purposes of the abandonment and subsidy standards all of this equipment should be assumed to be newly acquired at current prices, with no accrued depreciation; and that future depreciation charges should be based on this assumption.

Column A in the following table is computed as if these contentions had been accepted; column B is based on the standards adopted. Both columns assume an overall return of 8 percent.

	Dollar amounts in millions	
	A	B
Original cost	$400	$200
Accrued depreciation	.....	100
Net investment	400	100
Actual outstanding equipment debt	50	50
Balance for equity	350	50
Allowed return (8 percent on net investment)	32	8
Actual interest charges at 6 percent average	3	3
Net available for equity	29	5
Return on book equity (percent)	58	10
Annual depreciation (5 percent of original cost)	$20	$10
Total annual return plus depreciation	$49	$15
Ratio return plus depreciation to book investment (percent)	49	15

Where the debt-equity ratio in column B 75:25 instead of 50:50, the return on book equity would be 14 percent; if it were 90:10, the return on book equity would be 26 percent. If the latest equipment obligation was at 9 percent and other factors remained the same, the return on 50-cent equity in column B would be 12 percent; on 25-percent equity the return would be 18 percent; on 10-percent equity, 36 percent. These variations illustrate the effects of leverage. Having considered the legislative history and the contentions of the parties, the Commission is of the view that the return on equipment, exemplified by column B, more nearly comports with congressional intent.

FINDINGS

We find that Title 49, Chapter X, Subchapter B, Part 1121 of the Code of Federal Regulations requires amendment by the adoption of the regulations accompanying this report; that such regulations are reasonable and necessary; and that they should be adopted.

An appropriate order will be entered.

ORDER

At a General Session of the Interstate Commerce Commission, held at its office in Washington, D.C., on the 5th day of November 1976.

EX PARTE NO 274 (SUB-NO 2)

ABANDONMENT OF RAILROAD LINES AND DISCONTINUANCE OF SERVICE

Investigation of the matters and things involved in this proceeding having been made and the Commission, on the date hereof, having adopted its report with respect to the regulations (embodying their determinations by the Rail Service Planning Office as provided in section 205(e)(1)(B) of the Regional Rail Reorganization Act of 1973, as amended, to determine the "avoidable cost of providing rail freight service" as that phrase is used in section 1a(6)(a)(i)(A) of the Interstate Commerce Act, as amended), which regulations by order dated October 29, 1976, were adopted, and copy deposited with, among others, the Director, Office of the Federal Register, to be effective on November 1, 1976, are hereby referred to and made a part hereof:

It is ordered, That the referred to report be, and it is hereby, adopted as the report of the Commission.

By the Commission.

(SEAL)

ROBERT L. OSWALD,
Secretary.

APPENDIX F

F-9761

INTERSTATE COMMERCE COMMISSION

EX PARTE NO. 274 (SUB-NO. 2)

ABANDONMENT OF RAILROAD LINES AND DISCONTINUANCE OF SERVICE

EX PARTE NO. 274 (SUB-NO. 2)

ABANDONMENT OF RAILROAD LINES AND DISCONTINUANCE OF SERVICE

Decided April 21, 1977

Regulations issued November 1, 1976, to implement section 1a of the Interstate Commerce Act, relating to the abandonment of rail lines and the discontinuance of rail service, reconsidered, and amended in part.

Appearances as previously shown, and

Edward K. Wheeler and *Robert G. Seaks* for the Chicago and North Western Transportation Company.

REPORT OF THE COMMISSION ON RECONSIDERATION

BY THE COMMISSION:

By petitions filed, pursuant to rule 101 of the Commission's General Rules of Practice, the United States Department of Transportation (DOT), the Chicago and North Western Transportation Company (C&NW), the Railway Labor Executives' Association and the Brotherhood of Railway and Airline Clerks (RLEA and BRAC), and the Commonwealth of Pennsylvania (Pennsylvania) seek reconsideration of the final regulations adopted by the Commission, effective November 1, 1976, and served November 5, 1976, for the abandonment of railroad lines and discontinuance of service. Replies to petitions were filed by the Association of American Railroads (AAR), FS Service, Inc., and the International Minerals and Chemical Corporation (FS & International), the National Council of Farmer Cooperatives (NCFC), and the New York State Department of Transportation (NY DOT).

This proceeding was jointly instituted by the Commission and its Rail Service Planning Office by notice of proposed rulemaking and order (NPRO) dated July 30, 1976. Promulgation of new regulations for the abandonment of rail lines and the discontinuance of service

was required by the Railroad Revitalization and Regulatory Reform Act (4R Act), Public Law 94-210,[1] enacted February 5, 1976.

The Commission's report, containing the comments made by the parties, the conclusions of fact and law made thereupon by the Commission, and an explanation of reasons for the adoption of the final regulations was served November 10, 1976.

PROCEDURAL MATTERS

Prior to the issuance of the final report in this proceeding, RLEA-BRAC filed a motion, dated October 26, 1976, to strike certain reply comments of AAR. All replies in the proceeding were due September 28, 1976. The motion to strike, was not disposed of in the initial proceeding. Upon the determination that the issues raised by RLEA-BRAC's motion could properly be presented to the Commission for disposition at a later date, RLEA-BRAC were informed that no further action on their motion would be taken "at the present time." Before setting out the parties' position on reconsideration, RLEA-BRAC's motion must be disposed of.

The main thrust of the complaint and motion to strike arises out of the Commission's request in its NPRO for comments on:

> (1) whether it is appropriate and desirable to develop new conditions for the protection of employee interest in the rulemaking proceeding, or if time requires in a separate but similar proceeding, and (2) suggested content and form of provisions for protection of the interest of employees, consistent with section 1a(4) of the Act.

The initial comments of AAR refrained from any suggestion on the development of employee protective conditions. However, in their jointly filed comments, RLEA-BRAC did state that they doubted that the development of such a formula could be appropriately undertaken in this rulemaking proceeding and suggested that Rail Management and Rail Labor be brought together, under the aegis of the Commission, to develop an appropriate formula of protection. In item 2 of its reply comments, under the heading "Additional Materials," AAR disagreed with RLEA-BRAC that any purpose could be served by the suggested discussion between representatives of management and labor. Since AAR made no mention of employee protective provisions in its initial comments, RLEA-BRAC now assert that AAR improperly utilized a document specifically

[1] Amendments to the 4R Act, effected by section 218 of Public Law 94-555, the Rail Transportation Improvement Act, enacted October 19, 1976, were discussed in our report served November 10, 1976, and will not be reproduced here.

reserved for reply statements as a vehicle to submit direct statements, thereby depriving them of the right to reply.

Issues raised on direct or initial comments may be responded to by parties to the proceeding. However, neither due process nor section 553(b)(3) of the Administrative Procedure Act requires a party to a proceeding to be afforded the opportunity to reply to a reply. The suggestion that appropriate protective conditions be developed through discussions between Rail Management and Rail Labor was made initially by RLEA-BRAC. AAR disagreed with the suggestion and so stated in its reply. The fact that RLEA-BRAC made its suggestion without including a discussion of its perception of the new requirements of the law,[2] and under the mistaken belief that AAR would not oppose its suggestion, does not restrict replies thereto to generalized statements without support of legal argument. In our opinion, AAR's reply was a proper response to the suggestion put forth by RLEA-BRAC. The motion to strike is accordingly denied.

Reply of New York.—The deadline for filing replies was December 30, 1976. New York's reply was filed January 3, 1977, and was 1 day late because of the intervening holiday and weekend. New York's reply will be considered to the extent that it responds to the petition filed by DOT. This limits consideration of New York's reply to computation of off-branch costs, designated part 1(1) of the reply. The other portions of New York's reply, designated part 1(2) and 1(3), are not properly raised in that they do not respond to the contentions of DOT, but introduce new evidence broadening issues not subject to reconsideration.

SUMMARY OF PETITIONS

Petition of C&NW.—C&NW did not separately file an initial comment to the proposed abandonment regulations served by the Commission on July 30, 1976. However, since C&NW was represented by the Association of American Railroads, which filed initial comments on behalf of its member railroads, the C&NW is a proper party to this proceeding and is thereby entitled to submit its petition filed December 8, 1976, addressing the pertinent issues involved.

By its petition, C&NW requests elimination of the requirement for publication for those lines of railroad for which an abandonment

[2] In its notice of proposed rulemaking and order (p. 36) the Commission set forth its "preliminary view" that new section 1a(4) of the act required revision of the protective formula formerly used in abandonment cases.

application was pending at the time section 1121.22(c) of the regulations became effective. It points out that notices of pending abandonment proposals were posted and published in conformance with the requirements of the regulations in effect on October 31, 1976, and were served upon the Governor(s) of the State or States involved, the regulatory agencies of the State or States, rail users, and involved local communities.

C&NW argues that republication will be expensive and a hardship, and believes that republication and posting will cause a great deal of confusion with respect to abandonments pending final decision.

It also requests that the Commission issue a statement clarifying the requirements of section 1121.32(d)(1), concerning the use of the 12-month base year as a data base.

It is C&NW's interpretation of section 1121.32, that revenue and cost data shall be presented in accordance with the methodology of sections 1121.41-44 to the extent that such data are available for the base year. It believes this to be the correct interpretation of "base year" as defined by section 1121.11. The primary concern is that unless the Commission expresses a clarification of section 1121.32(d)(1), protestants to applications may interpret that section to preclude the filing of completed applications until the carrier has utilized the new accounting system for the subject branch line for a period of at least 12 months.

C&NW believes the Commission intended to implement the congressional intent that once a carrier has designated a line as a candidate for abandonment, it shall be permitted, after 4 months, to file an application for abandonment. It contends that it would, therefore, be appropriate for the Commission to issue such a statement of clarification to eliminate this potential for controversy.

Petition of DOT.—Dot seeks review of the regulations with respect to the filing of petitions to investigate and the formulation of specific requirements to be included in such petitions. Review is also requested of the provisions of the regulations pursuant to which the Commission may, based on changed circumstances, review its findings of public convenience and necessity when it is determined that a recalcitrant party has not engaged in meaningful negotiations with respect to a purchase or subsidy of a line. Dot also contends that its proposal for computation of off-branch costs is more appropriate than that adopted. In this respect, it contends that the Commission has not elucidated any reasons why the method adopted is preferable to the computation it proposed.

Petition of Pennsylvania.—By petition filed December 10, 1976, Pennsylvania requests redefinition of the requirements in section 1121.20(b)(1) and (2). It seeks to reduce the time period specified in section 1121.20(b)(1) from 3 years to 12 months. Additionally, it requests that the definition of a line in category 2 which is "potentially subject to abandonment" either read the same as section 1121.20(b)(2), but with an 18-month maximum time period instead of the previously mentioned 12-month period, or be deleted. Pennsylvania also believes that there are other reasons which make a line of railroad "potentially subject to abandonment," beyond those set forth in section 1121.20(b)(2) which must be included in the definition of that phrase as required by section 1a(5)(a) of the act.

Pennsylvania states that section 1121.36(a)(1) should be modified to require less information and no verification of a petition to investigate. It contends that the verification requirements impose an undue burden upon those parties desiring to protest an application and thereby seek to nullify the desire of Congress to *require* an investigation of proposed abandonments.

Pennsylvania furhter contends that the Commission is not permitted to determine the nature and extent of its investigation upon the filing of a petition to investigate according to the language of section 1a(3) of the act and requests section 1121.37(a)(1) be revised to require a full investigation upon receipt of such a petition.

Finally, Pennsylvania requests the Commission to clarify the proposition that subpart D branch line accounting standards do not apply to abandonment proceedings.

RLEA-BRAC's petition.—By their jointly filed petition, RLEA-BRAC contend that the Commission's report erroneously describes a case-by-case approach for the development of protective conditions. RLEA-BRAC request that the error be corrected and the Commission reconsider their suggestion that Rail Management and Rail Labor be brought together, under the aegis of the Commission, to adopt a negotiated protective formula. They further reiterate their suggestion that until an appropriate negotiated formula is developed, certificates issued pursuant to section 1a should include the following language:

> The interest of all railroad employees affected by approval of this abandonment (discontinuance) shall be protected by provisions at least as beneficial to such interests as provisions which have been established pursuant to section 5(2)(f) of the Interstate Commerce Act and pursuant to section 405 of the Rail Passenger Service Act.

RLEA-BRAC view section 1121.36(c)(1) of the adopted regulations, and the accompanying report, as erroneously restricting their right to require an investigation (1) limiting the time for filing petitions to investigate to 35 days and (2) by insinuating that rail labor organizations may not file in any case.[3] They allege that section 1a(3) of the amended act only requires the Commission to act on the issue of whether or not to investigate by the 55th day after the filing of the abandonment application and that the 35-day imposition is, therefore, legally questionable.

Finally, RLEA-BRAC restate their belief that the Commission improperly failed to rule upon their motion to strike before the report, which contained conclusions which could have been based on objectionable material, was issued.

SUMMARY OF REPLIES

NCFC.—NCFC limits its reply to the issues raised on petition by DOT. NCFC argues that an investigation is required when a petition to investigate is filed pursuant to section 1a(3) of the act and that, while the strict time limitations protect the carriers interests, the right to an investigation protects the public interest. Furthermore, NCFC believes the additional requirements for a petition to investigate proposed by DOT should not be incorporated in the final regulations since petitions considered frivolous by DOT may prove to be important to a small business or even an entire community.

NCFC supports the Commission's determination that it has the authority to reopen a proceeding where financial assistance negotiations have failed and deems the notice given by the Commission that it will reopen such proceedings a responsible act for the benefit of shippers.

NCFC believes DOT misconstrues section 307 of the 4R Act which requires the Commission to prescribe "a uniform cost and revenue accounting and reporting system for all common carriers by railroad" and supports the Commission's use of Rail Form A in its off-branch accounting system.

FS & International.—FS & International state that DOT was incorrect when arguing that the Commission had not justified adoption of section 1121.42(m) governing computation of off-branch costs. They contend that section 1121.42(m) is virtually identical to the regulation adopted in Ex Parte No. 293 (Sub-No. 2),

[3] At page 32 of our report we stated: "Because of the requirements of section 1a(4) of the Act, there is obviously no need to institute an investigation in such a case (as where rail labor organizations request the imposition of protective conditions)."

Standards for Determining Rail Service Continuation Subsidies, which governs the computation of such costs for subsidy purposes.

AAR.—AAR agrees with the position of DOT that substantial information should be contained in a petition to investigate, that the Commission is able to reject and not investigate incomplete or frivolous petitions, and that the Commission does not have the power to reopen an abandonment proceeding when negotiations between the applicant railroad and potential subsidizer have failed. In addition, AAR believes that the Commission does not have the power to require the railroad to continue operation of a line for an additional year without contravening the congressional provision that the Commission could postpone issuance of a certificate of abandonment for a period not to exceed 6 months.

AAR believes the proposals of DOT for computing off-branch costs to be less precise than Rail Form A, and, therefore, an inappropriate method of computing off-branch costs.

New York DOT.—New York agrees with DOT that the computation of off-branch costs should be reconsidered, but proposes a distinct manner of computing such costs based on New York's initial comments.

Specifically, New York believes that the costs of Account 269-Roadway Maintenance and Account 271-Small Tools and Supplies should be apportioned to each branch line on a ratio of maintenance costs performed on the branch to the total system maintenance costs. New York contends that the adopted standard fails to recognize the fact that roadway machines are used to a much greater degree on main line and heavy traffic branches than on light-density lines where maintenance is labor intensive and would thereby result in excessive charges unrelated to the actual use of roadway machines on branch lines.

DISCUSSION AND CONCLUSIONS

Section 1121.20 System diagram.—Pennsylvania has requested the Commission to reconsider the definition of lines of railroad in category 1, section 1121.20(b)(1), and reduce the time of anticipated filing of an application form 3 years to 12 months in order to prevent a rail carrier from destroying a railroad line.

At page 13 of our report we stated the purpose of category 1 to be two-fold: (1) to give notice to the users of the service provided over light-density branch lines, and the communities served by such lines,

the "base year" from data collected at the branch line level. "Base year" is defined in section 1121.11 as:

> The latest 12-month period, ending no later than six months prior to the filing of the abandonment or discontinuance application, for which data has been collected at the branch-level as prescribed in section 1121.40(b).

As first indicated in the notice of proposed rulemaking, carriers are required to maintain branch level revenue and cost data from the date a line is listed as potentially subject to abandonment.[4] A major purpose of this requirement is to insure that the applicant carrier will submit with its application the required supporting data and to defer the listing of lines which a carrier does not genuinely consider to be a future project for abandonment.

We agree with C&NW that Congress intended contested applications to be processed if the line proposed to be abandoned was listed in category 1 on the carrier's system diagram map 4 months prior to the date of filing of the application. As further pointed out by C&NW, some party to an abandonment application may misinterpret conformity with the 12-month-base-year requirement as a prerequisite to the filing of a completed application. This interpretation would be inconsistent with the statutory intent in that it would superimpose a 12-month moratorium on the processing of abandonment applications. Section 1121.32(d)(1) will, therefore, be clarified to indicate that the information provided for the base year must only be furnished to the extent that it is available.

Although a carrier must only begin its accumulation of branch line data when the line to be abandoned is designated on its map, we, nevertheless, would hope and expect that prudent rail management will begin its system of branch line data collection when it first reaches an internal decision to include a line in one of the pertinent categories. This forward-looking perspective would insure that the supporting data submitted is as accurate as possible and will minimize the necessity of supplementing the data at hearing.

Section 1121.36 Participation in proceeding.—Pennsylvania objects to the requirement that a petition to investigate be verified. On the other hand, DOT believes that there should be compliance with certain additional requirements, beyond those already adopted, in order to file such a petition. In this regard, AAR concurs with DOT. NCFC supports the concept of a petition to investigate as set forth in the Regulations.

[4] As revised, the regulations require railroads to maintain branch level revenue and cost data for all lines listed in categories 1-4.

The Commission is faced with the delicate task of equitably balancing the interests of all concerned parties while complying with the congressional intent expressed in section 1a(3) of the act.

We remain convinced that the proper balance is struck by requiring certain generalized information indicating the petitioner's interest in the proceeding, while also requiring that the petition be verified. By not requiring detailed submissions, we avoid discouraging the filing of legitimate petitions. On the other hand, the requirement for verification is the least restrictive precaution to the filing of frivolous petitions. By this, we do not suggest that Congress intended substantive qualifications for petitioners to be more than what was required for protestants in prior abandonment proceedings. However, unlike a protests to prior abandonment proceedings, a petition under the new regulations procedurally triggers an investigation. Since we do not believe Congress intended an investigation to be conducted on the basis of frivolous petitions, the verification requirement is necessary to establish the legitimacy of the petition and to promote the expeditious handling of abandonment proceedings.

This requirement should not pose an undue burden on petitioners. If a potential petitioner believes an objection to an application may be resolved without the Commission pursuing an investigation of the proposal he may simply file a comment. If a party wishes to file a petition, thereby triggering an investigation, the extent of which to be determined by the Commission, he should be prepared to participate to the extent required, and the verification of the petition is a very minimal requirement.

We further require a petition to investigate to be filed within 35 days of the date an application is filed. We also do not believe this requirement inflicts undue hardship in view of the notice given in advance that an abandonment application is going to be filed. The two general modes of notice give at least 4 months warning of the impending application via the system diagram map, and 30-days' notice from the posting and publishing requirements of section 1121.31 of the regulations. Thus, RLEA-BRAC, despite their objections to section 1121.36(c)(1), have sufficient time to prepare a petition to investigate.

RLEA-BRAC contend that the Commission, at page 32 of its report, seeks to deny rail labor the right to have an investigation instituted. This is not our intention. The language referred to at page 32 is intended simply to illustrate the type of objection to an

of an attempt by the carrier to abandon service; and (2) to give the Commission, other Federal agencies, the States, local communities, rail service users, and the carriers themselves an opportunity to plan intelligently and effectively to develop and maintain an integrated transportation system.

The 3-year time period appears lengthy in the perspective of one railroad line. However, there are two factors which, justify the 3-year time period. The first factor is the number of railroad lines designated in category 1. In order for the many involved parties to plan intelligently and effectively to develop and maintain an integrated transportation system, communication and consultation must take place between them. This is a lengthy process requiring a broad time frame. Secondly, all lines of railroad in category 1, will not be on the system diagram map for 3 years. Some lines of railroad may appear on the map in category 1 for only 4 months, as required by section 1a(5)(b) of the act. Because of the multitude and timing of abandonment applications filed, a 12-month time frame for a line to be in category 1 is entirely too short to be of value to any interested party. Therefore, the definition of a line of railroad in category 1 will not be changed.

Section 1121.20.—Pennsylvania petitioned the Commission either to redefine category 2, section 1121.20(b)(2), or to delete it from the system diagram map.

Category 2 complies with section 1a(5)(a) of the act which requires each system diagram map to include a detailed description of each line of railroad which is "potentially subject to abandonment as such term is defined by the Commission." It is our opinion that said definition should encompass lines of railroad which the carrier is studying for possible future abandonment.

Having already determined that the time frame of category 1 should not be redefined from 3 years to 12 months, we refrain from redefining category 2 as a carbon copy of category 1, with the only change being an 18-month time frame. Category 2 is designed to give the railroads an opportunity to study these lines while concurrently alerting the public to the possible loss of train service. This category does not include lines where an abandonment is being sought, but merely lines of railroad the carrier has under study for possible future abandonment; that is, those lines which are "potentially subject to abandonment." Two separate categories of lines, then, are mandated by statute and are necessary to fulfill the full intent of the act.

We will, however, rewrite category 2 to clarify that it defines lines "potentially subject to abandonment." Section 1121.20(b)(2) will read:

> All lines or portions of lines potentially subject to abandonment *are those* which the carrier has under study and believes may be the subject of a future abandonment application because of either anticipated operating losses or excessive rehabilitation costs, as compared to potential revenues. [Emphasis added for clarity.]

No other modifications need be made to category 2.

Section 1121.22 Filing and publication.—C&NW believes that the posting and publication requirements of section 1121.22(c) should be modified so as not to require posting and/or publication of those lines for which abandonment applications are presently pending before the Commission.

We view the republication of all abandonment proceedings that are in their initial stages as essential if planners are to be able to project an accurate picture of a future transportation system within their communities. We are of course cognizant of the fact that there will be some expense involved in republication. However, at the time the previous publication for most presently pending proceedings was effectuated, communities did not have available the prospect of subsidy funds for continued operation of the rehabilitation of light-density lines. The publication of each of the categories is an important part of the overall congressional plan to have the involved State or community develop an integrated transportation system. Viewed from this perspective, the additional expense the carrier will incur in complying with this regulation is not sufficient to overcome our belief that we should not amend the regulations, as requested, to accommodate a one-time event.

However, we recognize the validity of C&NW's argument as it pertains to republication for applications which are already set for oral hearing, modified procedure, or those for which an order has been issued finding the public convenience and necessity does not require further continued operation of the line. For those applications, we believe the proceedings are in such an advanced state that adequate notice has been accomplished and the expense involved in republication would not be justified or warranted. The regulations will be amended to reflect this conclusion.

Section 1121.32 Contents of application.—This section of the adopted regulations requires that the revenue and cost data included in an abandonment or discontinuance application be computed for

application that may be satisfied by the imposition of appropriate conditions without the institution of an investigation of the entire abandonment proposal. Thus, railway labor organizations may file petitions to investigate. However, it is our judgment that such petitions are unnecessary when employee protective conditions are the only substantive arguments raised and will automatically be imposed pursuant to section 1a(4) of the act.

Section 1121.37.—DOT, NCFC, and AAR agree that the Commission may use its discretion in instituting an investigation. Pennsylvania, however, believes that the Commission cannot determine the extent and type of investigation, but must conduct a "full investigation."

Section 1a(3) of the act states "the Commission shall, upon petition *** cause an investigation to be conducted ***." The word "shall" is imperative and does not imply the exercise of discretion. The statute, however, does not define investigation. There is no indication that Congress intended "hearing" and "investigation" to be synonymous. On the contrary, section 17 of the amended act states that "hearing" shall include written submissions of all evidence; but, section 1a(3) only states that an investigation is to assist the Commission in its determination. We also believe that a proper determination can be made without the "full investigation" in all instances, suggested by Pennsylvania. Therefore, the nature and extent of the investigation is left appropriately to the discretion of the Commission. Though one investigation may be of a broader scope or more formal than another, we shall conduct an investigation in compliance with the congressional mandate.

We find no reason to amend section 1121.37(a)(1) of the regulations.

Section 1121.38 Financial assistance procedures.—Prior to the issuance of the adopted regulations, numerous parties objected to section 1121.38(i)(2)(iii) providing for the reopening of the abandonment proceeding if subsidy negotiations failed after the allocated 6-month period. In our report we indicated that section 17(9)(g) of the act afforded the Commission authority to reopen any proceeding if there was evidence of "substantially changed circumstances." By its petition, DOT asserts that the changed circumstances must be central to the proceeding being reopened, and that subsidy negotiations are not central to the underlying abandonment.

The appropriateness of an offer of financial assistance under section 1121.38(f) does not influence a determination of whether a

certificate of public convenience and necessity should be issued in the first instance. However, this is only because the act makes the finding of public convenience and necessity permitting the abandonment a prerequisite to the consideration of a subsidy offer. That is to say, under the act, the initial findings are made in the absence of an offer and not in contemplation or anticipation of whether an offer would indeed be made. However, to assert that the statutory precondition to the consideration of a subsidy offer somehow precludes the reopening of the abandonment proceeding is inconsistent with the congressional intent that every opportunity be afforded to facilitate assistance program for the purpose of preserving rail service.

Traditionally, whether or not a certificate permitting an abandonment will be issued is determined upon the weighing of the burden imposed upon the carrier and interstate commerce against the public need for continued service. These considerations are not altered under the 4R Act, and the burden of proof remains with the applicant.

It seems clear that if a bona fide offer of subsidy could result in a change in the substantive factors that were determinative of the initial findings (*e.g.*, removal of the financial burden from the applicant carrier), then the subsidy offer produces a substantially changed condition central to the underlying abandonment proceeding.

We reemphasize that this power to reopen will be used sparingly, but remain firm in our belief that it is essential fully to effectuate the congressional intent.

AAR, in addition to agreeing with DOT's position that the Commission does not have the power to reopen an abandonment proceeding when negotiations fail, further contends that the Commission lacks the authority to require a railroad to continue operations for 1 year under such circumstances.

We recognize that a potential subsidizer may conceive it to be in his best interest to forestall successful negotiations in the hope of having the abandonment proceeding reopened or the carrier required to provide service for an additional year in return for compensation computed by the Commission.

On the other hand, when Congress provided in section 1a(6)(a) of the act that the Commission shall postpone the issuance of a certificate of abandonment for a period "not to exceed six months," we do not believe the intent was to provide a means whereby a recalcitrant carrier could unfairly preclude the reaching of a

reasonable agreement. The specific language of this section anticipates that an agreement will be reached within the 6-month period and cannot reasonably be interpreted to imply what should be done in the event negotiations fail. If, for example, the offeror agrees to pay the amount of subsidy, as computed in accordance with the standards in subpart D of the regulations, and the railroad nonetheless refuses the offer, we cannot conclude, under these circumstances, that either the law or public policy requires the Commission to issue a certificate permitting the abandonment.

Where the act does not specifically provide for the situation, the Commission has the obligation in promulgating its rules, to effectuate the full congressional intent in an adequate fashion. Accordingly, the four alternatives the adopted regulations outline in event of an impasse were designed to preclude both the potential subsidizer and the railroad from utilizing the language of the act as a club at the negotiation table. Since we are not persuaded that the four alternatives should be either deleted or modified, they will remain as adopted.

LABOR PROTECTIVE CONDITIONS

In our notice of proposed rulemaking and order we suggested that it might be appropriate protective conditions in this rulemaking proceeding rather than on a case-by-case basis. RLEA-BRAC did not favor this approach but suggested that the Commission direct rail labor and management to meet and attempt to develop an appropriate negotiated formula. Although we did not set RLEA-BRAC's suggestion out in detail in our report, it was not our intent to imply that they favored a case-by-case approach. In any event, our conclusion to proceed on a case-by-case method was not based on such an implication but upon the determination that the labor issues involved were substantive in nature and could be more properly resolved in the adversary setting of individual abandonment proceedings arising in the future. This rulemaking proceeding is primarily procedural in nature and not designed to develop a complete record sufficient to resolve substantive labor issues.

Section 1121.40 Standards for determining revenues, cost, et cetera.—Pennsylvania urges the Commission to clarify that the adopted rules of subpart D do not apply to the abandonment proceedings.

In our notice of proposed rulemaking, we clearly indicated that the revenue, cost, traffic, and other data submitted with the

application will be utilized by the Commission in determining whether the public convenience and necessity permit the abandonment of a rail line, by responsible persons to formulate offers of financial assistance to assure continued rail service, and by the Commission to determine the adequacy of any such offers.

Although elements other than revenues and costs enter into determining whether a proposed abandonment is permitted by the public convenience and necessity, there is no practical reason for a different data base or methodology for use in connection with the Commission's finding of public convenience and necessity and its findings for financial assistance purposes. Logic and sound administration dictate that they should be identical. If it were otherwise, the Commission, the railroad, and the public would be faced with the situation in which a possible offeror of financial assistance would not have the information necessary to formultate such an offer upon the filing of an abandonment application.

DOT requests reconsideration of its alternative proposal for computing off-branch costs. New York agrees with DOT that the method for computing off-branch costs should be reconsidered, but propose a distinct manner of computing such costs based on their initial comments. New York has filed similar comments under the regional standards developed in Ex Parte No. 293 (Sub-No. 2) pursuant to the Regional Rail Reorganization Act of 1973 (3RA).

In our notice of proposed rulemaking and order we stated that because the same basic terminology is used in the 3RA and in the new abandonment and discontinuance provisions, we believe the Congressional intent is that the national standards should follow the conceptual approach of the regional standards. Consequently the regional standards are being used to provide the foundation upon which the national standards are based. Since New York's comments are the same in this proceeding as in Ex Parte No. 293 (Sub-No. 2), we believe their comments may best be considered in that proceeding and any changes to the regional standards arising out of that proceeding will be reflected by appropriate adjustments to the national standards at a later date.

DOT's proposed method would compute off-branch costs by multiplying the carrier's operating ratio times its systemwide variable cost percentage, times the attributable branch revenues. This approach would not take into account the length of the off-branch haul or the characteristics of the traffic on the line. Furthermore, we do not perceive the relevance of the individual carrier's operating ratio to the calculation of off-branch costs. For

example, in 1975 the operating ratios of individual class I railroads (excluding Amtrak and Long Island) varied from a low of 33.1 percent for the Spokane International to a high of 125 percent for the Ann Arbor, but this does not signify that moving a particular carload of freight a given distance on the Ann Arbor would cost 3.8 times as much as a similar movement on the Spokane International. If the Ann Arbor's systemwide variable costs were assumed to be as much as 80 percent of total cost, the application of this proposed method would result in off-branch costs consuming all the revenues for every carload, regardless of the length of haul or the level of rates applying to the traffic involved. No matter how much rates were increased, it would be impossible for them to cover the off-branch cost so computed.

Since there is no consensus on an alternative methodology, and the method proposed by DOT is less precise than that established in subpart D, the adopted regulation governing the computation of off-branch costs will remain unchanged.

ADDITIONAL MATTERS

Section 1a(2)(a) of the amended act requires a carrier to submit to the Commission a notice of intent to abandon and have attached thereto an affidavit certifying that a copy of the notice was served on Governors, the Public Service Commission of the involved States, significant users of the line, and designated State agencies. The effect of this section is to require all publication and posting requirements for the notice to be completed before the Commission receives its notice of the carrier's intent to abandon. This presents an administratively undesirable situation since it is essential that the Commission also receive notice of the railroads' imminent plans to abandon at least concurrently with public notification. Our regulation, section 1121.30(a), will be revised to require that the carrier advise the Commission of its intent, by certified letter, concurrently with service of its first notice upon one of the required parties.

FINDINGS

Appended hereto are the revisions to the regulations, incorporating all the changes referred to in the report herein.

Based on the discussion hereinabove, the Commission finds that the revisions are reasonable and necessary and that this decision is

not a major Federal action significantly affecting the quality of the human environment within the meaning of the National Environmental Policy Act of 1969.

APPENDIX OF REVISIONS

Section 1121.20(b)(2) is revised as follows:

(b)(2) All lines or portions of lines potentially subject to abandonment are those which the carrier has under study and believes may be the subject of a future abandonment application because of either anticipated operating losses or excessive rehabilitation costs, as compared to potential revenues.

Section 1121.22(c) is supplemented by the addition of the following:

Republication of category 3 lines, which prior to November 1, 1976 were already set for oral hearing, modified procedure, or for which an order has been issued finding public convenience and necessity not to require future continued operation of the line, is not required for compliance with this section.

Section 1121.32(d)(1) is clarified to read:

(1) Computation of the revenues attributable, avoidable costs, and reasonable return on value for the line to be abandoned for the base year (as defined by section 1121.11(c) and to the extent such branch level data is available), in accordance with the methodology prescribed in section 1121.41-44, as applicable, and submitted in the form called for in section 1121.45, as exhibit 1.

Section 1121.30(a) is supplemented to read:

(a)(1) The applicant shall give notice of its intent to file an abandonment or discontinuance application by (1) serving notice on the Commission by certified letter at least concurrently with service upon those shippers who are significant users (as defined in section 1121.11(m) of this part) of the line proposed to be abandoned or discontinued, or at the time the notice is first published, whichever first occurs, on the Governor (by certified mail), on the Public Service Commission (or equivalent agency), and on the designated State agency of each State in which all or part of the line of railroad sought to be abandoned or over which service is proposed to be discontinued is situated, or at the time the notice is first published, whichever occurs first (2) ***

ORDER

At a General Session of the INTERSTATE COMMERCE COMMISSION, held at its office in Washington, D.C., on the 21st day of April 1977

EX PARTE NO. 274 (SUB-NO. 2)

ABANDONMENT OF RAILROAD LINES AND DISCONTINUANCE OF SERVICE

Upon further consideration of the record in this proceeding, the report and order of the Commission herein, effective November 1, 1976, wherein regulations for the abandonment of railroad lines and discontinuance of service were promulgated and adopted, the petitions of the United States Department of Transportation, the Chicago and North Western Transportation Company, the Railway Labor Executives' Association and the Brotherhood of Railway and Airline Clerks, and the Commonwealth of Pennsylvania, and the replies thereto filed by the National Council of Farmer Cooperatives, the Association of American Railroads, the New York

Department of Transportation, and jointly by FS Services, Inc. and the International Minerals and Chemical Corporation; and the Commission on the date hereof having issued its report on further consideration which report is made a part hereof:

It is ordered, That the revisions to the regulations as set forth in the appendix to the report be, and they are hereby, adopted;

It is further ordered, That this order shall become effective on the date it is served;

It is further ordered, That except as herein revised, modified, supplemented, or amended, the regulations and accompanying report and order effective November 1, 1976, in the above-entitled proceeding, shall remain in full force and effect; and

It is further ordered, That notice of this order shall be given to the general public by depositing a copy thereof in the Office of the Secretary of the Commission at Washington, D.C., and by filing a copy with the Director, Office of the Federal Register.

By the Commission.

ROBERT L. OSWALD,
Secretary.

(SEAL)

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